FILED
JUL 7 - 1999
OFFICE OF THE CLERK

No. 98-70

IN THE

Supreme Court of the United States

STEVEN W. BENNETT; EDMUND L. GILLOOLEY; JOSEPH L. ALESSANDRINI, JR.; FRANK W. HEWITT; RICHARD E. SEMARAD; WARREN E. KAYLOR, Individually and on behalf of all other similarly situated; JOANNE KELLY, Individually and on behalf of all others similarly situated; GEORGE E. GALE, III, Individually and on behalf of all other similarly situated,

Petitioners,

v.

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A. MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

ALAN M. SANDALS
Counsel of Record
HOWARD I. LANGER
SANDALS, LANGER & TAYLOR, LLP
One Liberty Place
50th Floor
Philadelphia, PA 19103
(215) 419-6500

(Cover Continued on Next Page)

153710

Counsel Press LLC
FORMERLY LUTZ APPELLATE SERVICES
(800) 274-3321 • (800) 359-6859

12458

DAVID BERGER
HAROLD BERGER
STANLEY R. WOLFE
BERGER & MONTAGUE, P.C.
1622 Locust Street
Philadelphia, PA 19103
(215) 875-3000

KENNETH I. TRUJILLO
IRA NEIL RICHARDS
TRUJILLO RODRIGUEZ
& RICHARDS, LLC
226 West Rittenhouse Square
Philadelphia, PA 19103
(215) 731-9004

Attorneys for Petitioners

QUESTIONS PRESENTED

Former long-service employees of Conrail who were participants in the Conrail Matched Savings Plan make claims regarding the fiduciaries' allocation and distribution of surplus Plan assets following the Plan's complete termination in May 1997. They also make claims regarding the fiduciaries' failure to allocate Plan assets following large reductions of employment in previous years, which allegedly caused a partial termination of the Plan. The employees claim that, in disregard of ERISA's strict fiduciary and other provisions that govern in these circumstances, the Plan fiduciaries are implementing an asset distribution scheme that ignores the equitable stake of the long-service employees in their Plan and instead allocates $533 million in surplus to employees who either were never participants in the Plan or had a less significant stake and history of participation in the Plan. The cases were dismissed for failure to state a claim and the Court of Appeals for the Third Circuit affirmed.

The questions presented are:

1. Whether the activities of allocating and disposing of surplus assets to participants after a complete termination of a non-reversionary ERISA plan are governed by ERISA's strict fiduciary duties, as three other circuits have held?

2. Whether the activities of allocating and disposing of these surplus assets to participants are also governed by the equitable allocation scheme mandated by ERISA § 4044(a), 29 U.S.C. § 1344(a), as two other circuits have held?

3. Whether an equitable allocation of assets, including surplus assets, to affected participants is also required following the partial termination of the plan, as one other circuit has held and as provided in the applicable Treasury Regulation?

PARTIES TO THE PROCEEDING

Petitioners are former long-service salaried employees of Conrail and its predecessor railroads whose employment ceased before the final termination of the Conrail Matched Savings Plan in which they have been participants. The eight named plaintiffs in the three consolidated actions below, petitioners here, are: Steven W. Bennett, Edmund L. Gillooley, Joseph L. Alessandrini, Jr., Frank W. Hewitt, Richard E. Semarad, Warren E. Kaylor, Joanne Kelly, and George E. Gale.

Defendants below, respondents here, are: the Conrail Matched Savings Plan Administrative Committee; its members, Deborah A. Melnyk and John/Jane Does 1-10; and the Consolidated Rail Corporation Matched Savings Plan.

TABLE OF CONTENTS

	Page
Questions Presented	i
Parties to the Proceeding	ii
Table of Contents	iii
Table of Cited Authorities	v
Table of Appendices	xi
Opinions Below	2
Statement of Jurisdiction	2
Statute Involved	2
Statement of the Case	3
A. Statement of the Facts	4
1. The Genesis of Conrail	4
2. The First Conrail ESOP	5
3. Creation of the Current Conrail ESOP	5
4. The Mass Terminations of Conrail Employees	6

Contents

Page

5. The Takeover Battle for Conrail 6

6. The Termination of the Conrail ESOP and Distribution of its Assets 7

B. District Court Proceedings. 10

C. Third Circuit Proceedings. 11

Reasons for Granting the Writ 13

I. The Circuits Are In Conflict Over The Application Of ERISA's Strict Fiduciary And Other Standards To Conduct Involving The Allocation And Disposition Of Assets On Final Termination Of A Plan. 13

II. The Third Circuit's Decision Improperly Expands The Scope Of Conduct That Is Immune From ERISA Oversight, Creates New Uncertainties For Regulation Of Defined Contribution And Other Terminating Plans, And Warrants Review By This Court. 22

Conclusion 25

TABLE OF CITED AUTHORITIES

Page

Cases:

Albedyll v. Wisconsin Porcelain Co. Revised Retirement Plan, 947 F.2d 246 (7th Cir. 1991), *aff'g*, 1989 U.S. Dist. LEXIS 10453 (W.D. Wis. 1989) 15

Audio Fidelity Corp. v. Pension Benefit Guaranty Corp., 624 F.2d 513 (4th Cir. 1980) 15, 16

Borst v. Chevron Corp., 36 F.3d 1308 (5th Cir. 1994), *cert. denied*, 514 U.S. 1066 (1995) 21

Central States, Southeast & Southwest Areas Pension Fund v. Central Transport, Inc., 472 U.S. 559 (1985) 20, 23

District 65, UAW v. Harper & Row Publishers, Inc., 670 F. Supp. 550 (S.D.N.Y. 1987) 14

Financial Institutions Retirement Fund v. Office of Thrift Supervision, 964 F.2d 142 (2d Cir. 1992) 13

Hawkeye National Life Ins. Co. v. AVIS Indus. Corp., 122 F.3d 490 (8th Cir. 1997) 18

Horn v. Berdon, Inc. Defined Benefit Pension Plan, 938 F.2d 125 (9th Cir. 1991) 15

Cited Authorities

	Page
Hughes Aircraft Co. v. Jacobson, __ U.S. __, 119 S. Ct. 755 (1999)	13, 16, 23
Jackson v. Truck Drivers' Union Local 42 Health & Welfare Fund, 933 F. Supp. 1124 (D. Mass. 1996)	14
John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 510 U.S. 86 (1993)	24
Lockheed Corp. v. Spink, 517 U.S. 882 (1996)	23
Malia v. General Elec. Co., 23 F.3d 828 (3d Cir. 1994)	12
Massachusetts Mut. Life Ins. Co. v. Russell, 473 U.S. 134 (1985)	24
Mead Corp. v. Tilley, 490 U.S. 714 (1989)	18
Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928)	15
Mut. Life Ins. Co. of New York v. Yampol, 840 F.2d 421 (7th Cir. 1988)	14
Nachman Corp. v. P.B.G.C., 446 U.S. 359 (1980)	20
NLRB v. Amax Coal Co., 453 U.S. 322 (1981)	15

Cited Authorities

	Page
P.B.G.C. v. Mize Co., Inc., 987 F.2d 1059 (4th Cir. 1993)	16
Phillips v. Bebber, 914 F.2d 31 (4th Cir. 1990)	16
Rinard v. Eastern Co., 978 F.2d 265 (6th Cir. 1992), *cert. denied*, 507 U.S. 1029 (1993)	19
Rosenbaum v. Davis Iron Works, Inc., 669 F. Supp. 813 (E.D. Mich. 1987), *aff'd mem.*, 871 F.2d 1088 (6th Cir. 1989), *cert. denied*, 493 U.S. 890 (1989)	19
Systems Council EM-3, I.B.E.W. v. AT&T Corp., 159 F.3d 1376 (D.C. Cir. 1998)	19
Varity Corp. v. Howe, 516 U.S. 489 (1996)	15, 24
Waller v. Blue Cross of California, 32 F.3d 1337 (9th Cir. 1994)	13
Statutes:	
26 U.S.C. § 411(d)(3)	12
28 U.S.C. § 1254(1)	2
28 U.S.C. § 1291	11
28 U.S.C. § 1331	10

Cited Authorities

	Page
29 U.S.C. §§ 1001 *et seq.*	2, 3
29 U.S.C. § 1001(a)	2
29 U.S.C. § 1001(b)	2
29 U.S.C. § 1103	3
29 U.S.C. § 1103(c)(1)	14
29 U.S.C. § 1103(d)(1)	16, 17, 23
29 U.S.C. § 1103(d)(2)	17
29 U.S.C. § 1104	3, 14
29 U.S.C. § 1104(a)(1)	14
29 U.S.C. § 1104(a)(1)(A)	14
29 U.S.C. § 1132(e)	10
29 U.S.C. § 1132(f)	10
29 U.S.C. § 1341(a)(1)	16
29 U.S.C. § 1344	3, 4, 11, 12, 15, 16, 17, 18, 19
29 U.S.C. § 1344(a)	i, 17, 18

Cited Authorities

	Page
29 U.S.C. § 1344(b)(2)	20
29 U.S.C. § 1344(d)	12, 18
29 U.S.C. § 1344(d)(3)(A)	20
Rule:	
Fed. R. Civ. P. 12(b)(6)	1, 2, 4, 10
Other Authorities:	
29 C.F.R. § 2618.4(a)	17
29 C.F.R. § 2618.32(a) (1981)	19
29 C.F.R. § 4041.8(a) (1997)	16
29 C.F.R. § 4041.8(b)	16
29 C.F.R. § 4044.3(a)	17
29 C.F.R. § 4044.4(a)	17
29 C.F.R. § 4044.30	19
61 Fed. Reg. 34002	19
2 Pomeroy, *Equity Jurisprudence* § 407 (5th ed. 1941)	20

Cited Authorities

	Page
Bogert, *Law of Trusts and Trustees* § 1010 (Rev. 2d ed. 1983)	20
CCH Pension Plan Guide, Plans and Clauses, Model Employee Stock Ownership Plan, ¶ 34,032	21
Letter from Dennis M. Kass, Asst. Secy., Pension & Welfare Benefits Admin., U.S. Dept. of Labor, to John N. Erlenborn, March 13, 1986, *reprinted in* 13 Pens. Rep. (BNA) 472-73 (March 17, 1986)	14
PBGC Op. Ltr. 91-4 (May 3, 1991)	14
Restatement (Second) of Trusts § 183	15
Restatement (Second) of Trusts § 232	15
Treasury Regulation § 1.411(d)-2 (1977)	3
Treasury Regulation § 1.411(d)-2(a)(2) (1977)	10, 12
Treasury Regulation § 1.411(d)-2(a)(2)(i)	21
Treasury Regulation § 1.411(d)-2(a)(2)(ii)	12
Treasury Regulation § 1.411(d)-2(a)(2)(iii)	21

TABLE OF APPENDICES

Page

Appendix A — Judgment And Opinion Of The United States Court Of Appeals For The Third Circuit Dated And Filed February 23, 1999 .... 1a

Appendix B — Memorandum Opinion And Order Of The United States District Court For The Eastern District Of Pennsylvania Dated And Filed October 30, 1997 And Entered October 31, 1997 ..... 21a

Appendix C — Class Action Complaint 45a

Appendix D — Order Of The United States Court Of Appeals For The Third Circuit Denying Petition For Rehearing Dated April 8, 1999 .... 67a

Appendix E — Relevant Statutes And Regulations 70a

The three consolidated appeals below arise from Rule 12(b)(6) dismissals of related actions challenging the scheme currently being implemented by the respondent fiduciaries of the Conrail Matched Savings Plan to distribute over $500 million of unallocated assets held in the Employee Stock Ownership Plan ("ESOP"), an ERISA plan which covered petitioners and other current and former employees of Conrail. Petitioners are former long-service employees of Conrail who are current or former participants in both the ESOP and the Conrail Matched Savings Plan of which the ESOP is a part.

In 1996 and 1997, Norfolk Southern Corporation and CSX Corporation waged a tender offer battle for control of Conrail. In April 1997, the companies agreed to jointly purchase Conrail and divide its assets. Their tender offer was consummated in May 1997 and all of the outstanding shares of Conrail, including the special class of preferred shares owned by the ESOP, were purchased for cash. After these transactions the value of the ESOP assets exceeded the vested benefits of all participants, yielding a surplus in the amount of approximately $533 million. The Plan and ESOP did not permit any of these surplus assets to revert to the employer.

On May 22, 1997, Conrail terminated the Matched Savings Plan and ESOP. After the termination had occurred, on June 12, 1997 management purported to amend the Plan to add a scheme for distributing the surplus assets. Under this challenged scheme, the respondent plan fiduciaries are in the process of distributing the fruits of the Conrail venture only to themselves and other Conrail employees who are employed during the distribution period. Petitioners allege that the distribution scheme improperly confers gigantic windfalls upon employees who have little employment service with Conrail and/or who never participated in the Plan. The scheme also unfairly favors highly-paid senior management of Conrail, who are acting in self-interest to distribute the assets in this manner. Respondents

are literally giving away plan money — to themselves, recent hires and even people who had never been participants in the Plan — and thereby ignoring the statutory and equitable interests of petitioners and other long-service participants.

This case tests whether ERISA, an act intended to "assur[e] the equitable character" of plans and to "establish[ ] standards of conduct, responsibility and obligation for fiduciaries," 29 U.S.C. § 1001(a), (b), permits this inequitable and self-interested distribution of plan assets in contravention of the statutory regime for plan terminations.

OPINIONS BELOW

The opinion of the Court of Appeals for the Third Circuit, dated February 23, 1999, 168 F.3d 671, 1999 U.S. App. LEXIS 2713, 1999 WL 86842, 22 E.B.C. 2717, is reprinted in the attached Appendix at 4a - 20a. The following orders and opinions are also reprinted in the Appendix: April 8, 1999, Order denying petition for rehearing and rehearing *en banc* (3d Cir.) (A. 67a); February 23, 1999, Judgment on entry of decision below (3d Cir.) (A. 1a); and October 30, 1997, 1997 U.S. Dist. LEXIS 17295, 1997 WL 700538 (E.D. Pa.) (decision granting Rule 12(b)(6) motions to dismiss) (A. 21a - 44a).

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals for the Third Circuit was entered February 23, 1999. Petitioners' timely petition for rehearing and rehearing *en banc* was denied by Order dated April 8, 1999. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Relevant provisions of the Employee Retirement Income Security Act of 1974 "ERISA"), as amended, 29 U.S.C.

§§ 1001 *et seq.*, are set out in the Appendix. Included are relevant portions of the following: § 403, 29 U.S.C. § 1103 (Establishment of trust; anti-inurement of plan assets; termination of plans) (A. 70a); § 404, 29 U.S.C. § 1104 (Fiduciary duties) (A. 72a); and § 4044, 29 U.S.C. § 1344 (Allocation of assets on termination of plans) (A. 73a). The Appendix also includes the relevant portions of Treasury Regulation § 1.411(d)-2 (1977) (Termination or partial termination of plans) (A. 84a).

STATEMENT OF THE CASE

Petitioners are eight former Conrail employees and participants in the Plan and ESOP. Seven of the petitioners had given dedicated service to Conrail for 18 to 20 years following its creation in 1976; they were each employed in the railroad industry for a total of 29 to 39 years. Nevertheless, because petitioners were not active employees of Conrail as of the time it terminated the ESOP and then later adopted the challenged distribution scheme, they will receive only limited or no distributions of the unallocated ESOP assets. Respondents are (1) the Conrail Matched Savings Plan Administrative Committee, the named fiduciary and statutory administrator of the Plan and ESOP; (2) the individual members of the Committee, Deborah A. Melnyk and the remaining members sued as John/Jane Does 1-10, who likewise are fiduciaries of the Plan and ESOP; and (3) the Consolidated Rail Corporation Matched Savings Plan, an individual account, defined contribution retirement savings plan governed by ERISA.

Petitioners claim that the fiduciary respondents violated ERISA by implementing the inequitable and arbitrary distribution scheme chosen by Conrail management. Upon the complete termination of the Plan and ESOP on May 22, 1997, ERISA required the fiduciary defendants to follow the statute and regulations applicable to disposition of plan assets on a complete termination. The fiduciaries' distribution of assets

pursuant to the scheme adopted by management after the termination of the ESOP (1) violates the command of ERISA § 4044 mandating equitable allocation of the unallocated assets based on the proportionate interest of each ESOP participant, whether or not the participant is currently employed; (2) violates ERISA's strict fiduciary duties because it is tainted by the self-interest of the respondent fiduciaries, who stand to receive much larger asset distributions if they exclude former employees from the distribution; (3) discriminates in favor of higher paid senior management of the company; and (4) ignores that petitioners and other former employees are also entitled to receive an allocation of assets due to the partial termination that has occurred in the Plan.

A. Statement of the Facts

Petitioners alleged the following facts in their Complaints.[1] Under the familiar strictures of Fed. R. Civ. P. 12(b)(6), the lower courts were required to assume that petitioners could prove all of these facts and the reasonable inferences to be drawn from them.

1. *The Genesis of Conrail*

In the late 1960's and early 1970's, a number of the freight railroads providing service in the northeastern and midwestern United States went bankrupt. In 1974, the Congress nationalized these rail freight lines and created Conrail. To assure the success of Conrail, petitioners and other employees were required to accept cuts in compensation and benefits and/or to forego increases in compensation. (Complaint ¶¶ 19-20, A. 52a).

---

1. The complaints in *Bennett* and *Kelly* are virtually identical. The complaint in *Gale* is substantially similar and differs only in its definition of the proposed class and certain factual allegations. These differences are not material to the matters presented and petitioners accordingly refer to the illustrative *Bennett* complaint, which is set out at A. 45a - 66a.

2. *The First Conrail ESOP*

Conrail had a long history of substantial ownership by current and former employees. In November 1978, the Congress conditioned the grant of economic assistance to Conrail on the mandatory creation of an employee stock ownership plan not later than May 1980, which was to own 15% of Conrail. By the Conrail Privatization Act of 1986, the Congress mandated that Conrail be privatized by means of a public stock offering for the 85% of the company not owned by the current and former employees through the Conrail ESOP. The legislation also provided that all stock and other assets held by the first Conrail ESOP be distributed to both current and former plan participants within 180 days of the initial public offering of Conrail stock. On October 1, 1987, all of the assets of the first Conrail ESOP were distributed to active, separated and retired Conrail employees. (Complaint ¶¶ 21-22, A. 52a - 53a).

3. *Creation of the Current Conrail ESOP*

By virtue of the statutes governing it, Conrail enjoyed immunity from any hostile takeover, even after becoming a public company in 1987, until April 1, 1990. In anticipation of expiration of this immunity, the Conrail Board of Directors adopted a number of measures intended to minimize the possibility of a hostile takeover. One measure was the creation of a new employee stock ownership plan. (Complaint ¶¶ 23-24, A. 53a).

The current Conrail ESOP was established in 1990, six days before the expiration of Conrail's statutory protection from hostile takeover. The ESOP covered only non-unionized employees, the labor organizations representing unionized workers having opted not to participate in this form of benefit. The ESOP assets consisted of shares of a special class of preferred stock issued solely to the ESOP. Employees of Conrail thereby became the owners of 10% of the company. Conrail

management proclaimed that the ESOP was "intended to motivate Conrail's employees to increase profitability and will serve to further align employee and shareholder interests." The new ESOP also was presented as a replacement for a program of retiree medical benefits, which Conrail eliminated in July 1990 for employees who then were younger than age 50. (Complaint ¶ 25, A. 54a).

The ESOP was implemented as a separate portion of the § 401(k) voluntary employee savings plan, the Consolidated Rail Corporation Matched Savings Plan. Under the Plan, employees were provided the opportunity to accumulate retirement savings by electing voluntary deferrals of portions of their compensation. Conrail matched employees' salary deferrals, dollar for dollar, in an amount not to exceed 6% of salary, with allocations of the Conrail preferred stock held in the ESOP. (Complaint ¶ 26, A. 54a).

4. *The Mass Terminations of Conrail Employees*

After the ESOP was established, Conrail implemented a series of actions to either involuntarily terminate employees who were participating in the ESOP or induce their resignations or retirements by means of special voluntary retirement and resignation programs. As a result of these actions, approximately 2000 ESOP participants have been separated from active employment. A substantial number and a substantial percentage, estimated to be in excess of 40%, of the employees who previously were ESOP participants have been severed from employment as of the date of the Complaint. These events constitute a partial termination of the Plan. (Complaint ¶¶ 27-29, 44-45, A. 55a, 61a - 62a).

5. *The Takeover Battle for Conrail*

Upon the disclosure of the CSX tender offer in October 1996, Norfolk Southern Corporation initiated its own rival

tender offer and mounted legal challenges to the Conrail-CSX agreement. In March 1997 CSX and Conrail amended the merger agreement to permit CSX to discuss with Norfolk Southern a joint plan for acquisition of Conrail and division of its assets and to form a jointly owned entity with Norfolk Southern to acquire Conrail. (Complaint ¶¶ 30-31, A. 56a). The revised tender offer was successful and substantially all shares of Conrail stock, including the ESOP's shares of preferred stock, were tendered. The cash proceeds were remitted to the ESOP. (Complaint ¶¶ 32-34, A. 57a). Upon completion of the tender offer Conrail ceased to be a publicly traded, independent company. (Complaint ¶¶ 36-37, A. 57a - 58a).

6. *The Termination of the Conrail ESOP and Distribution of its Assets*

After completion of the tender offers, the ESOP held as unallocated, surplus assets the proceeds for approximately 7.3 million shares of common stock. After paying off the outstanding balance of the ESOP loan used to purchase the shares from Conrail, the ESOP held net unallocated assets of at least $533 million. (Complaint ¶ 38, A. 58a). According to Conrail CEO David LeVan, the "primary contributor" to the status of the ESOP "was the hard work that [employee participants] put into this company that helped create tremendous value for shareholders." (Complaint ¶ 41, A. 60a).

Plan documents presented by respondents in support of their motion to dismiss established that the Matched Savings Plan and ESOP were "terminated effective May 22, 1997 . . . and no further contributions have been made following that date." (Plan Restatement, 3d Cir. App. at A 107). In his June 1997 cover letter to plan participants explaining the ESOP distribution scheme, Conrail CEO LeVan stated that, "Consistent with the Merger Agreement among Conrail, CSX and NS, we have terminated the ESOP portion of the 401(k) Matched Savings Plan." (Complaint ¶¶ 40-41, A. 59a - 60a).

After the Plan was terminated, Conrail management purported to amend the Plan on June 12, 1997 (Third Amendment to Plan, dated June 12, 1997, 3d Cir. App. at A 093-099). On or about June 11, 1997, Conrail management announced their scheme to distribute the unallocated ESOP assets to certain employees, including, apparently, the respondent members of the Administrative Committee. The scheme confers massive financial rewards[2] on current Conrail employees no matter how brief their employment. It allocates retroactively, only to the accounts of ESOP participants who were employed in 1996, an amount representing a supposed maximum possible allocation for calendar year 1996. It proposes to allocate in 1997, only to the accounts of ESOP participants who are employed in 1997, an amount equal to the supposed maximum possible allocation for that calendar year. To increase the 1997 allocation, Conrail will refund from the Savings Plan

---

2. The challenged distribution scheme, coupled with applicable asset valuation rules based on the initial 1990 cost basis of the Conrail stock, results in new employees or new ESOP participants receiving a far greater share of the assets than petitioners and other participants who gave lengthy service to Conrail and had long participated in the ESOP. The decision below mistakenly presumed that under the challenged distribution scheme, the maximum amount of assets that any employee could receive during a year is $30,000 (Opinion at 10, A. 15a.). In fact, the record before both lower courts showed that under IRS valuation rules only the cost basis of the Conrail stock is taken into account in computing payments to employees. *See, e.g.*, 3d Cir. App. at 131 (plan provision computing allocations based on "aggregate cost basis of stock"); Petitioners' 3d Cir. Opening Brief at 27 (referring to "applicable asset valuation rules based on the initial 1990 cost of the Conrail stock"). Given the fact that at the time of termination of the ESOP the stock had appreciated to an average price of $113.16, an amount that was 3.9232 times its original cost, a newly hired Conrail executive who was not even a participant in the ESOP at the time of its termination would be able to receive maximum payments totaling $353,088 over the course of three years. Petitioners allege that these ESOP pay-outs are in addition to extremely generous "stay pay" and severance bonuses for current employees (Compl. ¶ 39, A. 59a).

all of the employees' voluntary 1997 salary deferral contributions and all of the investment earnings thereon. For 1998, Conrail proposes to again allocate the supposed maximum possible amount to those ESOP participants who are still employed in 1998. Conrail projects that this scheme should consume all of the unallocated assets, but notes that this may not be accomplished due to employee attrition or changes in employee compensation. As a result, a shrinking pool of employees, believed to disproportionately represent highly compensated and senior management who will also receive enhanced bonus and incentive pay, would divide among themselves the benefits of the enhanced value of the ESOP, to the detriment of petitioners and other ESOP participants who are no longer employed by Conrail. This disfavored treatment of petitioners and the proposed class will occur despite their frequently lengthy and dedicated service, their contributions to the success of the company, and their financial stakes in the Plan. (Complaint ¶ 39, A. 58a - 59a).

The scheme for distributing unallocated ESOP assets does not fairly and equitably allocate the assets. First, the scheme provides no distribution at all to participants who were severed from employment before 1996. Second, the scheme provides only a limited distribution to those participants who were employed during some part of 1996 but who were no longer employed by Conrail at the time of the Plan termination. In contrast, employees who did not contribute any of their funds to the Plan, or who were not even participants in the Plan at the time it was terminated, will receive the largest distributions for 1996. (Complaint ¶ 42, A. 60a - 61a).

Third, the scheme also ignores the lengthy service, economic concessions, and other contributions of petitioners and other ESOP participants to Conrail's success and the resulting magnitude of the unallocated ESOP assets. For example, a current Conrail employee will receive a substantial distribution despite the fact that he or she was only recently

hired by the company, or only recently became an ESOP participant, or had not contributed anything to the Plan. Fourth, the scheme confers ever-greater relative benefits upon a shrinking group of participants who happen to have the good fortune to keep their jobs at Conrail, such as senior management and executives who are able to negotiate for their own job security. Finally, the scheme discriminates in favor of employees who are officers or managers, or who otherwise are highly compensated employees. (Complaint, ¶ 42, A. 60a - 61a).

B. District Court Proceedings.

Before any discovery had occurred in the district court, respondents moved to dismiss the cases under Fed. R. Civ. P. 12(b)(6). By opinion and order dated October 30, 1997, the court, per District Judge Harvey Bartle, III, granted the motion to dismiss in its entirety (A. 21a - 44a). The district court's federal question jurisdiction was based upon 28 U.S.C. § 1331 and 29 U.S.C. § 1132(e) and (f).

With respect to petitioners' claim that a partial termination occurred in the Plan and ESOP, the court ruled that no claim could be stated on the facts alleged. First, the court ruled that the only consequence of a partial termination could be the vesting of unvested benefits. Inasmuch as the employees were always fully vested in their individual account balances in the ESOP, vesting of benefits would not be pertinent to this case (Opinion at 13-14, A. 32a - 34a). The court rejected arguments that under the governing Treasury Regulation § 1.411(d)-2(a)(2) (1977) (A. 84a), a partial termination requires the fiduciary plan administrator to make an equitable allocation to participants of the unallocated plan assets where the participants have a legal interest in these assets. The court instead relied upon inapposite decisions in cases where participants had no legal interest in the unallocated assets and extracted a general rule that allocation of assets is not required upon a partial (or complete) termination (Opinion at 12-13, A. 32a - 33a).

Second, the court determined that the asset allocation provisions of ERISA § 4044, 29 U.S.C. § 1344, were not applicable and that the respondent ESOP fiduciaries did not violate the law in failing to distribute the assets according to this equitable statutory method (Opinion at 14-16, A. 34a - 36a). The court ruled that § 4044 would apply only if the Plan had expressly referred to it. The court did not consider the fact that under ERISA's specific provisions, resort to this section is mandatory and self-executing.

Third, the court ruled that no claim could be stated about the complete termination of the Plan and ESOP that occurred in May 1997. The court reasoned that the equitable distribution scheme of § 4044 only applies where some plan assets will revert to the employer. Even then, according to the court, the section would only require an allocation to participants of that portion of the unallocated assets attributable to employee contributions (Opinion at 16-17, A. 36a - 37a). The court also ruled that petitioners' allegations of respondents' conflicts of interest, breach of the duties of loyalty to participants, and unlawful discrimination in favor of senior managers, including the fiduciary respondents themselves, were immaterial because petitioners had no interest in the assets (Opinion at 17-18, A. 37a - 38a).

C. Third Circuit Proceedings.

Petitioners initiated timely appeals to the Court of Appeals for the Third Circuit. The court rendered its decision on February 23, 1999 in an opinion authored by Judge Roth, joined by Judge Sloviter and District Judge Feikens (sitting by designation) (A. 1a - 20a). A timely petition for rehearing and rehearing *en banc* was denied by Order dated April 8, 1999 (A. 67a - 69a). The Court of Appeals' jurisdiction was based upon 28 U.S.C. § 1291.

The Third Circuit first considered petitioners' claim regarding the alleged partial termination of the Plan. The court concluded that the applicable statute, 26 U.S.C. § 411(d)(3), did not expressly refer to an allocation of assets on a partial termination, and that a share of surplus assets was not a "benefit" within the meaning of the statute (Opinion at 6-8, A. 9a - 12a). The court also rejected petitioners' claim that an allocation of assets was required by the express terms of Treasury Regulation § 1.411(d)-2(a)(2), ruling that such an allocation of surplus would not constitute a "liability" to participants under the plan. As its sole support for this conclusion, the court cited its decision in *Malia v. General Elec. Co.*, 23 F.3d 828, 832 (3d Cir. 1994), a case involving a merger of ongoing plans rather than a partial termination (Opinion at 8-9, A. 12a - 13a). Finally, although § 1.411(d)-2(a)(2)(ii) of the regulation expressly invokes ERISA § 4044, 29 U.S.C. § 1344, the court concluded without discussion of the regulation that this provision was not applicable to a partial termination and that any unfairness in the distribution scheme was not actionable (Opinion at 9-10, A. 13a - 15a).

With respect to petitioners' claims that the fiduciaries violated their strict fiduciary duties and the specific terms of ERISA § 4044 by implementing the inequitable, tainted distribution scheme for the surplus assets, the court ruled first that § 4044 would govern the distribution only if there had been a distribution of surplus assets attributable to employee contributions, the circumstance addressed by § 4044(d) (Opinion at 11-12, A. 16a - 18a). Second, characterizing petitioners' fiduciary breach claims as relating solely to the amendment of the Plan (rather than the fiduciaries' actions in distributing the assets), the court ruled that the amendment was not subject to fiduciary standards. Determining that petitioners had no interest in the surplus assets and "lack standing to challenge the manner in which the surplus is ultimately distributed," the court "[took] no position at this time whether the scheme is in accord with ERISA" (Opinion at 12-13 & n.6, A. 18a - 19a).

REASONS FOR GRANTING THE WRIT

I.

THE CIRCUITS ARE IN CONFLICT OVER THE APPLICATION OF ERISA'S STRICT FIDUCIARY AND OTHER STANDARDS TO CONDUCT INVOLVING THE ALLOCATION AND DISPOSITION OF ASSETS ON FINAL TERMINATION OF A PLAN.

The Court should act to review this case because the decision of the Third Circuit creates conflicts among the circuits on several important principles governing ERISA regulation of terminated plans. The Third Circuit did not acknowledge these conflicts.

First, the decision conflicts with decisions of other courts of appeals, as well as applicable Department of Labor guidance, holding that allocation and distribution of plan assets upon a plan termination is an administrative activity constrained by ERISA's strict fiduciary duties. As a general matter, fiduciary duties clearly are implicated by "such actions as the administration of the plan's assets." *Hughes Aircraft Co. v. Jacobson*, __ U.S. __, 119 S. Ct. 755, 763 (1999). To be sure, the threshold decision to declare a plan termination is a non-fiduciary employer-"settlor" function. But once a plan termination is declared, the decisions and methods for *implementation* of the termination are fiduciary in nature. *See Waller v. Blue Cross of California*, 32 F.3d 1337, 1342-43 (9th Cir. 1994) (plaintiffs' claims relate to implementation of decision to terminate, not decision itself; "We believe that this distinction is dispositive and hold that Blue Cross acted in a fiduciary capacity when choosing annuity providers to satisfy plan liabilities."); *Financial Institutions Retirement Fund v. Office of Thrift Supervision*, 964 F.2d 142, 148-49 (2d Cir. 1992) ("There can be no doubt that the [Retirement] Fund's directors were administering or managing the plan when they decided to

allocate the [surplus asset] balances to the Banks"; alleged taint from conflict of interests sufficient to state claim for violation of ERISA § 404); *Mut. Life Ins. Co. of New York v. Yampol*, 840 F.2d 421, 425 (7th Cir. 1988) (Liquidator appointed by state insurance commissioner was fiduciary due to responsibility in management of health plan and disposition of its assets); *Jackson v. Truck Drivers' Union Local 42 Health & Welfare Fund*, 933 F. Supp. 1124, 1143 (D. Mass. 1996) ("A distinction must be drawn . . . between the decision to terminate a plan and the manner in which that decision is implemented."); *District 65, UAW v. Harper & Row Publishers, Inc.*, 670 F. Supp. 550, 556-57 (S.D.N.Y. 1987) ("decisions regarding disposition of plan assets upon termination" are discretionary fiduciary acts). It is also the longstanding position of the Department of Labor, the agency charged with enforcing ERISA fiduciary standards, that "Allocation decisions [under § 4044] clearly involve the type of disposition of plan assets generally treated as fiduciary activity. Thus, when the plan administrator acts pursuant to section 4044, his activities will also be subject to the fiduciary duty provisions of ERISA." Letter from Dennis M. Kass, Asst. Secy., Pension & Welfare Benefits Admin., U.S. Dept. of Labor, to John N. Erlenborn, March 13, 1986, *reprinted in* 13 Pens. Rep. (BNA) 472-73 (March 17, 1986); *see also* PBGC Op. Ltr. 91-4 (May 3, 1991) (citing DOL letter).

Management and disposition of assets on a plan termination are fiduciary activities. The allocation of the surplus assets following the ESOP's termination accordingly is governed by ERISA's strict fiduciary duties, including the mandate to discharge administrative duties "solely in the interest of the participants and beneficiaries" and "for the exclusive purpose of providing benefits" to them, 29 U.S.C. § 1104(a)(1), (a)(1)(A). "The assets of a plan . . . shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries." 29 U.S.C. § 1103(c)(1). The actions by the fiduciary respondents here to allocate substantial plan assets to persons who at the time of termination had never been

participants in the ESOP violate these strict duties. ERISA fiduciaries, like common law trustees, also must scrupulously avoid situations in which their duties to participants may be tainted by conflict of interests. "[T]he rule against a trustee dividing his loyalties must be enforced with 'uncompromising rigidity.' " *NLRB v. Amax Coal Co.*, 453 U.S. 322, 329-30 (1981), *quoting Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, C. J.). Finally, fiduciaries must also "take impartial account of the interests of all beneficiaries." *Varity Corp. v. Howe*, 516 U.S. 489, 514 (1996), *citing Restatement (Second) of Trusts* §§ 183, 232 (duty of impartiality). Respondents' actions to allocate assets in a manner that favors current employees over other participants, that ignores the equitable stake of each participant, and that favors the fiduciaries themselves and other members of senior management, violate this duty as well.

Second, the Third Circuit's ruling approves the inequitable distribution scheme adopted by Conrail *after* the plan had been terminated. This authorization of retroactive amendments made after plan termination conflicts with decisions of other courts of appeals holding strictly that, "The scheme established by ERISA relies upon the provisions of each plan at the time of termination. It would defeat congressional intent and render §§ 1103(c)(1) and 1344(d)(1) nugatory if retroactive amendments after termination could alter substantive rights of the pension plan." *Audio Fidelity Corp. v. Pension Benefit Guaranty Corp.*, 624 F.2d 513, 517 (4th Cir. 1980); *see also Horn v. Berdon, Inc. Defined Benefit Pension Plan*, 938 F.2d 125, 128 (9th Cir. 1991); *Albedyll v. Wisconsin Porcelain Co. Revised Retirement Plan*, 947 F.2d 246, 251 (7th Cir. 1991), *aff'g*, 1989 U.S. Dist. LEXIS 10453 at * 24-25 (W.D. Wis. 1989). The decision also conflicts with regulations of the Pension Benefit Guaranty Corporation, the agency charged with enforcing the terms of ERISA § 4044. The regulations make clear that plan assets must be distributed in accordance with

the plan terms *as they exist at the time of termination*. "A participant's or beneficiary's plan benefits are determined under the plan's provisions in effect on the plan's termination date." 29 C.F.R. § 4041.8(a) (1997).[3] The regulation goes on to provide that "in a plan in which participants or beneficiaries will receive some or all of the plan's residual [surplus] assets based on an allocation formula," the amount of each participant's share of the surplus assets is "is determined under the plan's provisions in effect on the termination date" and a post-termination amendment is not given effect if it decreases a participant's share of residual assets. 29 C.F.R. § 4041.8(b). The decision, below, by recognizing post-termination plan amendments that alter the manner in which surplus assets are to be allocated, thus establishes a conflict with both decisions of other courts of appeals and regulations of the agency charged with enforcing the statute.

Third, the decision in this case conflicts with circuit decisions holding that the ERISA statute, and specifically § 4044, 29 U.S.C. § 1344, is the exclusive, mandatory method for terminating a plan and distributing its assets. As this Court noted in *Hughes Aircraft*, 119 S. Ct. at 764, the procedures defined in the ERISA statute "by which an employer may voluntarily terminate a plan" are "the sole avenues for voluntary termination." Under the preexisting decisions of other circuits, "Strict compliance with the statute is the sole means by which a pension plan subject to the provisions of ERISA may be terminated." *P.B.G.C. v. Mize Co., Inc.*, 987 F.2d 1059, 1063 (4th Cir. 1993), *quoting Phillips v. Bebber*, 914 F.2d 31, 34 (4th Cir. 1990) (*per curiam*); *see also* 29 U.S.C. § 1341(a)(1) ("Exclusive means of plan termination").

The statute repeatedly makes clear that ERISA §§ 403(d)(1) and 4044 establish a mandatory regime that plan administrators

---

3. Although this particular regulation was not promulgated in final form until November 7, 1997, it reflects longstanding policy of the PBGC, as confirmed in caselaw such as *Audio Fidelity*.

must follow when allocating and distributing all of the assets of a plan upon its termination. *See* 29 U.S.C. § 1103(d)(1) ("*the assets of the plan shall be allocated* in accordance with the provisions of section 4044"); 29 U.S.C. § 1344(a) ("the plan administrator *shall allocate the assets of the plan*"); 29 C.F.R. § 4044.3(a) ("the plan administrator *shall allocate the plan assets*"; "Plan assets available to pay for benefits include *all plan assets* . . .").[4]

The decision below cites 29 U.S.C. § 1103(d)(2) as requiring that assets be distributed "in accordance with the terms of the plan," Opinion at 11, A. 16a. But that provision by its express terms applies only to "the assets of a *welfare* plan." Assets of defined contribution plans such as the ESOP must instead be allocated "in accordance with the provisions of section 4044" and this categorical directive contains no reference to, or room for, contrary plan terms. 29 U.S.C. § 1103(d)(1). The Third Circuit also correctly notes that, by operation of 29 U.S.C. § 1103(d)(1), the distribution of surplus assets on termination of the Conrail ESOP was governed by the borrowed statutory scheme for termination of defined benefit plans, ERISA § 4044, 29 U.S.C. § 1344 (Opinion at 11, A 16a). However, the decision fails to take into account that at the time of the ESOP termination on May 22, 1997, there were no plan terms governing distribution of the surplus assets. Accordingly, the distribution of the assets was governed solely by the statute and governing regulations and general equitable principles.

The decision below also construes § 4044 as not governing distributions of surplus assets to participants unless there is an

---

4. The PBGC regulations implementing § 4044 provide that a plan administrator violates ERISA "if plan assets are allocated or distributed upon plan termination in a manner other than that prescribed in" the section. 29 C.F.R. § 4044.4(a) (promulgated July 1, 1996); 29 C.F.R. § 2618.4(a) (replaced; promulgated October 8, 1981).

employer right of partial reversion (Opinion at 12, A. 17a - 18a).[5] The decision holds that the surplus ESOP assets are not governed by ERISA § 4044(a), 29 U.S.C. § 1344(a), because no assets were reverting to the employer. This ruling is contrary to decisions of this Court and other appeals courts. *See Mead Corp. v. Tilley*, 490 U.S. 714, 717 (1989) (on plan termination, "ERISA requires that plan assets be distributed to participants in accordance with the six-tier allocation scheme set forth in § 4044(a)."); *Hawkeye National Life Ins. Co. v. AVIS Indus. Corp.*, 122 F.3d 490, 498 (8th Cir. 1997) ("Congress has impliedly recognized in § 1344 that residual assets are merely a subset of assets of a plan and that residual assets are therefore a form of plan assets."). Inasmuch as § 4044 must govern the asset distribution from the ESOP, and section (a) is the only provision that can apply to the circumstances of this case involving a non-reversionary plan, this is what subjects the matter to statutory regulation.

Fourth, the Court of Appeals having ruled that the statutory regime of § 4044 was not applicable, it also held that the inequitable distribution scheme could not be challenged. This is contrary to authority from other courts of appeals, the PBGC regulations, and general equitable principles which all provide that ERISA requires an equitable allocation of surplus plan assets on a *pro rata* basis according to the account values of all participants at the time of termination, whether or not they happen to be current employees. The PBGC regulations promulgated under § 4044, 29 U.S.C. § 1344, have historically provided that where a plan does not allow for a reversion to the

---

5. The decision below mistakenly ascribed to petitioners the argument that 29 U.S.C. § 1344(d) governed the distribution of ESOP surplus (Opinion at 12, A. 17a). In fact, petitioners made clear that this was not their position. They instead had argued that, because § 1344(d) has a limited operation only where an employer reversion will occur, the distribution of the surplus in this case is governed by 29 U.S.C. § 1344(a).

employer, unallocated "residual" assets "shall" be allocated to "each member of the pool of eligible participants and beneficiaries" by pro-rating the unallocated assets based on the ratio that the individual's accrued benefit bears to the sum total of the accrued benefits of all participants and beneficiaries. 29 C.F.R. § 2618.32(a) (1981).[6]

Decisions of other courts of appeals confirm that in the event of a plan termination where surplus assets are to be allocated to participants, this rule of proration must be followed. In *Rinard v. Eastern Co.*, 978 F.2d 265, 269 (6th Cir. 1992), *cert. denied*, 507 U.S. 1029 (1993), the Sixth Circuit determined that there was no right of employer reversion in a terminated plan and that "the surplus belongs to [plaintiffs — 93 former employees or surviving spouses] and must be equitably distributed to the plaintiffs under the supervision of the District Court." *See also Systems Council EM-3, I.B.E.W. v. AT&T Corp.*, 159 F.3d 1376, 1380 (D.C. Cir. 1998) ("if the pension plans at issue had actually terminated immediately prior to the spin-off, appellants would have been entitled to a pro rata share of any residual assets;" citing regulation); *Rosenbaum v. Davis Iron Works, Inc.*, 669 F. Supp. 813, 820 (E.D. Mich. 1987) (applying regulation), *aff'd mem.*, 871 F.2d 1088 (6th Cir. 1989), *cert. denied*, 493 U.S. 890 (1989).

Section 4044 likewise follows the rule of equitable proration and directs that assets be allocated equitably in other analogous circumstances. For example, where plan assets are insufficient

---

6. This former PBGC regulation, 29 C.F.R. § 2618.32(a), was in force from 1981 to 1996 and remains the best indication of the method by which surplus assets that do not revert to the employer must be allocated pursuant to ERISA § 4044. On July 1, 1996, the PBGC "reinvented," revised and renumbered its regulations. The revision lists the provision governing allocation of surplus assets as "Reserved." 29 C.F.R. § 4044.30. The commentary accompanying the 1996 regulation states, however, that none of the regulatory amendments "affects applicable substantive legal requirements." 61 Fed. Reg. 34002.

to fund all benefits in a given asset allocation category, "the assets shall be allocated pro rata among such individuals on the basis of the present value (as of the termination date) of their respective benefits." 29 U.S.C. § 1344(b)(2) (A. 76a); *see also Nachman Corp. v. P.B.G.C.*, 446 U.S. 359, 381 n.32 (1980) (section provides for "automatic pro rata distribution"). The statute also requires that in reversionary plans involving employee contributions, a defined portion of surplus assets "shall be equitably distributed to the participants who made such contributions." 29 U.S.C. § 1344(d)(3)(A) (A. 81a). The decision below is also contrary to the well-established principle of proration of assets under trust law and general equity jurisprudence. *See* Bogert, *Law of Trusts and Trustees* § 1010 (Rev. 2d ed. 1983) (on final distribution of trust assets, trustee should distribute property pro rata among beneficiaries); 2 Pomeroy, *Equity Jurisprudence* § 407 (5th ed. 1941) (when several persons are entitled to participate in a common fund, equity will decree a pro rata distribution). "Trustees' responsibilities and powers under ERISA reflect Congress' policy of 'assuring the equitable character' of the plans." *Central States, Southeast & Southwest Areas Pension Fund v. Central Transport, Inc.*, 472 U.S. 559, 570 (1985).

Finally, the Third Circuit's decision also creates a conflict with respect to the application of asset distribution rules when a partial termination occurs in a plan. Petitioners claimed that a partial termination had occurred in the ESOP during years preceding the actual termination and that this required an allocation of surplus assets to petitioners and other affected participants. Although the decision below correctly assumed that the factual predicate for a partial termination could be proven, Opinion at 6, A. 10a, it erred in its conclusions about the effect of this event in a plan that does not allow an employer reversion and in which all assets must ultimately be allocated to participants. The governing Treasury Regulation expressly states that as a tax-qualified plan the Conrail ESOP must

"provide[ ] for the allocation of any previously unallocated funds to the employees [i.e., participants] covered by the plan upon the termination *or partial termination* of the plan." Treas. Reg. § 1.411(d)-2(a)(2)(i) ("Required allocation") (emphasis added) (A. 84a - 85a).[7] In *Borst v. Chevron Corp.*, 36 F.3d 1308, 1317, 1318 n.17 (5th Cir. 1994), *cert. denied*, 514 U.S. 1066 (1995), the Fifth Circuit confirmed that on a partial termination, surplus assets must be allocated to participants where the plan itself either provides for this allocation or, alternatively, precludes a reversion of surplus to the employer.

Contrary to the decision of the Fifth Circuit and the Treasury Regulation, the decision below now holds that the rule requiring allocation of assets on a partial termination does not operate in the case of the ESOP plan surplus, because surplus can never be a benefits "liability" and therefore need not be allocated by operation of § 1.411(d)-2(a)(2)(iii) (Opinion at 8, A. 12a - 13a). This construction ignores that the regulation governs all plans and thus necessarily governs plans with surpluses. The regulation specifically calls for allocations of assets that are not existing benefits liabilities, such as allocations "from the suspense account," Treas. Reg. § 1.411(d)-2(a)(2)(i) (A. 85a). The provision excepting from the mandated allocation "amounts [that] are not required to be used to satisfy the liabilities with respect to employees and their beneficiaries," § 1.411(d)-2(a)(2)(iii) (A. 86a - 87a), does not change the analysis in cases like this involving a non-reversionary plan. The provision contains the reference, "see [Internal Revenue Code] section

---

7. Consistent with the partial termination regulation, standard reference works setting forth model language for qualified plans provide for the required allocation of unallocated assets on partial or complete termination. *See, e.g.*, CCH Pension Plan Guide, Plans and Clauses, Model Employee Stock Ownership Plan, ¶¶ 34,020, 34,032 at § 12.2 (upon partial termination, trustee shall "allocate and segregate for the benefit of the Employees then or theretofore employed by the Employer with respect to which the Plan is being terminated the proportionate interest of such Participants in the Trust Fund.").

401(a)(2)," and this reference explains its purpose. The cited Code section prohibits use or diversion of plan assets to an employer until all plan liabilities have been satisfied. Inasmuch as the regulation applies generally to all plans, including plans that *do* allow employer reversion, the exception only serves the limited purpose of accommodating a reversionary feature when it is present. The conflicting construction and reasoning adopted by the Third Circuit would negate the regulatory regime by holding that surplus assets are never subject to the regulation, even on a complete termination.

In each of these five areas, the Third Circuit's decision conflicts with decisions of other circuits. The Court should act to resolve these variant rulings.

II.

THE THIRD CIRCUIT'S DECISION IMPROPERLY EXPANDS THE SCOPE OF CONDUCT THAT IS IMMUNE FROM ERISA OVERSIGHT, CREATES NEW UNCERTAINTIES FOR REGULATION OF DEFINED CONTRIBUTION AND OTHER TERMINATING PLANS, AND WARRANTS REVIEW BY THIS COURT.

This case has exceptional importance reaching beyond the thousands of current and former Conrail employees who have an interest in the hundreds of millions of dollars in dispute. The questions presented, relating to fiduciary and other statutory requirements in the context of terminations of non-reversionary ERISA plans, have become increasingly important due to the growing prevalence of defined contribution plans, including ESOPs, which typically do not provide for any reversion of surplus assets to the employer and which therefore present questions regarding the equitable distribution of surplus assets far more often than do defined benefit plans. These defined contribution retirement plans serve as the principal source of retirement security for millions of men and women. Despite

the great importance of these plans, little guidance is available to define the rights of participants and the duties of fiduciaries in the circumstance of plan terminations. Although the regulatory regime governing defined benefit plans is invoked for these plans by ERISA § 403(d)(1), the Pension Benefit Guaranty Corporation has no direct jurisdiction over these plans. Yet, at the same time, the Third Circuit's decision has a broad reach affecting all plans, and thereby creates new uncertainties and difficulties in all areas subject to the ERISA and PBGC regulatory regime for terminating plans. To date in this case, the views of the PBGC and the Department of Labor have not been considered.

Although this case concerns a *terminated* plan and the allocation of plan assets following the termination, the decision below relies inappropriately on the Court's decisions confirming employer discretion in designing plan benefits in an ongoing plan or in merging two ongoing plans. Opinion at 9, 13, A. 14a, 20a, *citing Hughes Aircraft, supra*; *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996). Unlike *Hughes Aircraft* and *Lockheed*, this case raises the very different problem of the equitable distribution of a plan's surplus assets to participants after the plan has been terminated. Until the Third Circuit's ruling, the caselaw held that the disposition of assets of a terminated plan was subject to review under ERISA's fiduciary and other standards. As a general matter, "The employer's fiduciary duties . . . consist of such actions as the administration of the plan's assets," *Hughes Aircraft*, 119 S. Ct. at 763, and the statute makes clear that the allocation of assets to participants following a plan termination is a distinctly administrative and hence fiduciary act. The decision below, however, immunizes these critical matters from any examination under ERISA.

This Court has emphasized that ERISA imposes "strict standards" on benefits plan administrators and other fiduciaries, *Central States, Southeast & Southwest Areas Pension Fund v. Central Transport, Inc.*, 472 U.S. 559, 570-72 & n.10 (1985),

"[t]o help fulfill ERISA's broadly protective purposes." *John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 510 U.S. 86, 96 & n.5 (1993). Despite repeated pronouncements of these general principles, the Court has had only one opportunity, in *Varity*, to explain the application of ERISA's strict duties to a fiduciary activity governed by them. *Varity* deals with fiduciary duties relating to communications about plan benefits. The Court has not yet addressed the application of fiduciary duties to the use and disposition of plan assets, activities that were "the crucible of congressional concern" in enacting ERISA. *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 141 n.8 (1985).

The conflicting decision by the Third Circuit appears to be the first holding that no provisions of ERISA, neither its general provisions nor its strict fiduciary duties, govern the allocation of surplus assets on the termination of a non-reversionary defined contribution plan, and that a court has no authority to examine any asset allocation scheme that may be implemented, no matter how tainted its genesis or how inequitable or absurd its consequences. The decision threatens to spawn a dramatic, improper expansion of the scope of transactions that are deemed to be immune from regulation under ERISA's strict fiduciary standards and other provisions.

The question of defining the parameters of fiduciary conduct and ERISA regulation, particularly in the context of terminating plans, warrants the Court's attention and guidance. This case presents an excellent vehicle to settle this important question and the conflicts among the circuits that have emerged in the caselaw and to establish certainty in the regulatory spheres occupied by the Pension Benefit Guaranty Corporation and the Department of Labor.

CONCLUSION

For the foregoing reasons, petitioners respectfully pray that the petition be granted and that a writ of certiorari issue to the Court of Appeals for the Third Circuit.

Respectfully submitted,

ALAN M. SANDALS
Counsel of Record
HOWARD I. LANGER
SANDALS, LANGER & TAYLOR, LLP
One Liberty Place, 50th Floor
Philadelphia, PA 19103
(215) 419-6500

DAVID BERGER
HAROLD BERGER
STANLEY R. WOLFE
BERGER & MONTAGUE, P.C.
1622 Locust Street
Philadelphia, PA 19103
(215) 875-3000

KENNETH I. TRUJILLO
IRA NEIL RICHARDS
TRUJILLO RODRIGUEZ
& RICHARDS, LLC
226 West Rittenhouse Square
Philadelphia, PA 19103
(215) 731-9004

Attorneys for Petitioners

APPENDIX

APPENDIX A — JUDGMENT AND OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED AND FILED FEBRUARY 23, 1999

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 97-1916/1917/1918

STEVEN W. BENNETT; EDMUND L. GILLOOLEY; JOSEPH L. ALESSANDRINI, JR.; FRANK W. HEWITT; RICHARD E. SEMARAD; WARREN E. KAYLOR, Individually and on behalf of all other similarly situated

v.

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A. MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN

Steven W. Bennett; Edmund L. Gillooley; Joseph L. Alessandrini, Jr.; Frank W. Hewitt; Richard E. Semarad; Warren E. Kaylor, Individually and on behalf of all members of the proposed class,

Appellants in 97-1916.

JOANNE KELLY, Individually and on behalf of all others similarly situated

v.

Appendix A

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A. MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN

Joanne Kelly,

Appellant in 97-1917.

GEORGE E. GALE, III, Individually and on behalf of all other similarly situated,

Appellant in 97-1918.

v.

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A. MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil Action Nos. 97-cv-04535; 05017 & 05345)

Present: Sloviter and Roth, *Circuit Judges*, Feikens, *District Judge**

---

* The Honorable John Feikens, United States District Court Judge for the Eastern District of Michigan, sitting by designation.

Appendix A

JUDGMENT

These causes came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel on July 13, 1998.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of said District Court entered October 31, 1997, be, and the same is hereby affirmed. Costs taxed against appellants. All of the above in accordance with the opinion of this Court.

ATTEST:

s/ P. Douglas Sisk
Clerk

Dated: 23 February 1999

Appendix A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 97-1916/1917/1918

STEVEN W. BENNETT; EDMUND L. GILLOOLEY; JOSEPH L. ALESSANDRINI, JR.; FRANK W. HEWITT; RICHARD E. SEMARAD; WARREN E. KAYLOR, Individually and on behalf of all other similarly situated

v.

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A. MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN

Steven W. Bennett; Edmund L. Gillooley; Joseph L. Alessandrini, Jr.; Frank W. Hewitt; Richard E. Semarad; Warren E. Kaylor, Individually and on behalf of all members of the proposed class,

Appellants in 97-1916.

JOANNE KELLY, Individually and on behalf of all others similarly situated

v.

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A.

Appendix A

MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN

Joanne Kelly,

Appellant in 97-1917.

GEORGE E. GALE, III, Individually and on behalf of all other similarly situated,

Appellant in 97-1918.

v.

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A. MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil Action Nos. 97-cv-04535; 05017 & 05345)

* * *

JUDGES: Before: SLOVITER AND ROTH, Circuit Judges FEIKENS,[1] District Judge.

---

1. The Honorable John Feikens, United States District Court Judge for the Eastern District of Michigan, sitting by designation.

Appendix A

OPINION OF THE COURT

ROTH, Circuit Judge:

Appellants are former employees of Conrail Corporation. They challenge the distribution of surplus assets of an employee stock ownership plan ("ESOP" or the "Plan"). The Plan is governed by the Employee Retirement Income Securities Act ("ERISA"). We must decide whether ERISA entitled the former employees to a portion of the cash surplus in the Plan that resulted from a favorable tender offer for Conrail's stock. Appellants argue that under ERISA they are entitled to share in the surplus and that Conrail's failure to permit them to do so violates fiduciary duties imposed by ERISA. We conclude that appellants were not entitled to participate in the apportionment of the surplus and that the District Court correctly dismissed their claims.

I. FACTS

In 1990, Conrail established a voluntary savings plan for non-union employees. The Plan was a defined contribution plan[2] and included an employee stock ownership plan and a deferred compensation plan. To get

---

2. In a defined contribution plan "employees are not promised any particular level of benefits; instead they are promised only that they will receive the balance in their individual accounts." *Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633, 637 n.1, 110 L. Ed. 2d 579, 110 S. Ct. 2668 (1990).* This is in contrast to a defined benefit plan which provides a fixed benefit to the employee. *29 U.S.C. § 1002*(35).

established, the Plan borrowed $290 million from Conrail to purchase a specially created class of Conrail preferred stock. This stock was held in an unallocated account. Participating employees contributed a portion of their salary into individual accounts and Conrail matched these contributions with stock from the unallocated account. These contributions vested immediately. Under the Plan, "all amounts allocated to the Account of a Participant shall be fully vested and nonforfeitable at all times." Conrail Plan Agreement, P 12.1. The benefits, which accrued under the defined contribution plan, were based solely on the performance of the shares in the individual accounts. As the District Court noted, the benefits depended on the vagaries of the marketplace.

Shortly after establishing the Plan, Conrail began to terminate employees. A terminated employee was entitled "to a distribution of all amounts credited to his account." Conrail Plan Agreement, P 8.1. Appellants do not dispute that they were fully vested and that, when they were terminated by Conrail, they were credited with the total vested balance in their individual accounts.

In 1997, Norfolk Southern and CSX Corporations made a favorable tender offer to purchase Conrail. The tender offer was for all outstanding shares of Conrail stock, including shares held in the unallocated account. The price Norfolk Southern and CSX paid for the stock was substantially in excess of its market value. After the Plan repaid Conrail the funds which it had borrowed to establish the Plan, the Plan's share of the proceeds from the tender offer resulted in a cash surplus of approximately $533 million in the unallocated account.

In June 1997, the Plan was amended to allocate this surplus to persons employed by Conrail from 1996-1998.[3] The amendment provided that these allocations would be made to the maximum extent allowed under the Internal Revenue Code (either $30,000 or 25% of annual compensation for the eligible employee, whichever is less). Employees terminated or otherwise separated from employment with Conrail before 1996 were not eligible to share in the surplus. Appellants are among this ineligible group.

Appellants brought suit in the U.S. District Court for the Eastern District of Pennsylvania, alleging two counts of ERISA violations. The District Court concluded that appellants received their accrued benefits as mandated by ERISA and for that reason they were not entitled to share in the surplus. The District Court dismissed both counts for failure to state a claim under Rule 12(b)(6). This appeal followed.

II. JURISDICTION AND STANDARD OF REVIEW

The District Court had jurisdiction over this action based on *28 U.S.C. § 1331* and *29 U.S.C. § 1132*(e). We

---

3. Under the Plan, Conrail's Board of Directors could "amend or terminate, in whole or in part, the Plan . . . at any time and in any manner, without prior notification. . . . no amendment to the Plan shall decrease a Participant's benefit or eliminate an optional form of distribution. No amendment shall make it possible for any assets of the Plan to be used for or diverted to any purpose other than for the exclusive benefit of Participants and Beneficiaries." Plan at P 14.1.

have jurisdiction over the appeal of the dismissal pursuant to *28 U.S.C. § 1291.* We review a dismissal under Rule 12(b)(6) under a plenary standard of review. *Malia v. General Electric Co., 23 F.3d 828, 830 (3d Cir. 1994).*

III. DISCUSSION

Appellants' complaint set forth two counts, alleging violations of ERISA. First, they claim that Conrail violated ERISA and tax code provisions governing partial and complete termination of pension plans. In the second count, they allege that under ERISA, Conrail breached its fiduciary duty by amending the Plan to adopt an inequitable distribution scheme. Appellants contend that on its termination, the Plan was essentially a "wasting trust" and therefore Conrail had a duty to distribute all its assets equitably.

A. Partial Termination

We turn first to appellants' claim that a partial termination occurred and that the partial termination mandated distribution of a share of the unallocated assets to appellants. Appellants contend that the Plan was partially terminated when in 1990, shortly after Conrail had established it, Conrail started laying off employees. Appellants argue that, under the Internal Revenue Code, a partial termination requires the distribution of unallocated Plan assets to the terminated employees. *26 U.S.C. § 411*(d)(3).

The District Court assumed that the employees were correct in contending that the layoffs constituted a partial

termination of the Plan. This assumption is consistent with our conclusion in *Gluck v. Unisys Corp., 960 F.2d 1168, 1183 (3d Cir. 1992)*, that "partial termination . . . involves a significant reduction in plan liability by means of a corresponding reduction in employee benefits. That reduction may be achieved either by excluding a segment of employees, or by reducing benefits generally." Since we have found that excluding employees through layoffs is a "vertical partial termination," id., the District Court reasonably assumed that a partial termination had occurred.

This conclusion does not, however, help appellants. Even though a partial termination of the Plan may have occurred, the tax code does not afford the appellants the relief they seek. Appellants argue that the Internal Revenue Code requires any partially terminated tax-qualified pension plan to distribute benefits to all "affected employees." They cite to *26 U.S.C. § 411*(d)(3), which provides that a plan will retain its tax qualified status if

> upon its termination or partial termination . . . the rights of all affected employees to benefits accrued to the date of such termination, partial termination, or discontinuance, to the extent funded as of such date, or the amounts credited to the employees' accounts are nonforfeitable.

Appellants' reliance on this section is, however, misplaced. Section 411(d)(3) refers only to "benefits accrued." The code defines "benefits accrued" for defined contribution plans as the balance in the individual's account.

26 U.S.C. § 411(a)(7)(A)(ii).[4] In addition, as § 411(d)(3) makes clear, affected employees are entitled to "benefits accrued to the date of such termination, [or] partial termination." Appellants were fully vested in the balance in their accounts when they were laid off, but their contributions to the Plan ceased at that time. The Plan would not reopen as to them to gather in further assets to accrue for their benefit. Indeed, by the express language of the Plan, only participants having a base salary earned for services could contribute to the Plan. Plan Agreement, P 3.1 and p. 3. For that reason, after their lay-off, appellants were no longer entitled to receive new benefits in the Plan.

Moreover, appellants are conflating accrued benefits with plan assets. Assets and benefits are treated differently under ERISA. As we noted in *Malia*:

> "benefits" are elements that are conceptualized and treated differently in a plan termination than are "assets" of that plan. "Benefits" are computed in a different manner than "assets." Accrued benefits are placed on the liability side, rather than on the asset side of the balance sheet.

23 F.3d at 832.

In *Malia*, two pension plans merged resulting in surplus assets. Participants sued to receive the surplus in addition to their benefits under the defined benefit plan. In upholding

---

4. ERISA also defines "accrued benefit" as the balance of an individual's account. *29 U.S.C. § 1002*(23)(B).

the dismissal of the employees' claims, we held that assets and benefits are distinct. Unallocated assets are not the same as accrued benefits. ERISA protects only anticipated benefits, not surplus assets.

We came to a similar conclusion in *Chait v. Bernstein, 835 F.2d 1017 (3d Cir. 1987),* where, in considering the applicability of § 411(d)(3) of the tax code to a claim for surplus assets after a partial termination of an employee benefit plan, we held that "the purposes and policies of partial terminations under the tax code do not apply in the context of vested employees attempting to gain plan surplus." *Id. at 1021.*

The appellants argue, however, that Treasury Regulation § 1.411(d)-2(a)(2)(i) supports their position that they are entitled to their share of the surplus. This regulation provides that, in order for a plan to remain a tax qualified one upon partial termination, unallocated funds must be allocated to covered employees:

> (2) Required allocation. (i) A plan is not a qualified plan . . . unless the plan provides for the allocation of any previously unallocated funds to the employees covered by the plan upon termination or partial termination of the plan . . . .

Treas. Reg. § 1.411(d)-2(a)(2)(i). As the District Court pointed out, however, this regulation does not "require the allocation of amounts to the account of any employee if such amounts are not required to be used to satisfy the liabilities with respect to employees and their beneficiaries under the plan." Treas. Reg. § 1.411(d)-2(a)(2)(iii).

The question then is whether the accumulation of a surplus in a plan may properly be considered an outstanding liability of that plan. We conclude that it should not be so considered. As we determined in *Malia*, accrued benefits are liabilities of a plan; assets (such as surplus) fall on the other side, the asset side, of the balance sheet. See *23 F.3d at 832.*

Nevertheless, appellants argue that, since the Plan contains no employer reversion provision, there is nowhere for the surplus to go but to them.[5] For this reason, they contend, distribution of the surplus must be considered an outstanding liability. While appealing in its simplicity, this "by process of elimination argument" fails because, as we have pointed out, benefits are a liability of a plan; assets are not.

We conclude, therefore, that both under the relevant portions of the tax code and under the applicable treasury regulations, appellants are not entitled to share in the surplus upon partial termination of the Plan.

Appellants next urge that Conrail's failure to distribute surplus assets to them upon partial termination of the Plan constituted a breach of the duties imposed by ERISA. Their first argument relies on *29 U.S.C. § 1344* (§ 4044 of ERISA). They contend that § 1344 requires that, upon termination, plan assets be distributed equitably. However, § 1344

---

5. Typically, defined contribution plans do not include a provision for reversion to the employer. See H.R. Conf. Rpt. No. 841, 99th Cong., 2d Sess. at Vol. II-482 (1986), reprinted in 1986 U.S.C.C.A.N. 4078, 4570.

applies to the partial termination of a plan only when the plan provides that it do so. *Ashenbaugh v. Crucible Inc., 1975 Salaried Retirement Plan, 854 F.2d 1516, 1529 n.15 (3d Cir. 1988).* The Conrail Plan does not so provide. Therefore, appellants' argument that § 1344 should apply to this partially terminated plan is unavailing.

Finally, appellants argue that the distribution scheme simply is unfair. They contend that they assumed the risk of the market performance of the Conrail stock throughout their tenure at Conrail and now they are being excluded when it comes time to realize the reward of its increase in value. However, ERISA does not confer substantive rights on employees; rather it ensures that they will receive those benefits that the employers have guaranteed to them. See *Hughes Aircraft Co. v. Jacobson, No. 97-1287, 1999 WL 24546,* at *6 (U.S. Jan. 25, 1999). As we stated in Malia:

> ERISA provides for comprehensive federal regulation of employee pension plans . . . . The major concern of Congress was to ensure that bona fide employees with long years of employment and contributions realize anticipated pension benefits.

23 F.3d at 830, quoting, Reuther v. Trustees of Trucking Employees of Passaic and Bergen County Welfare Fund, 575 F.2d 1074, 1076-77 (3d Cir. 1978). While ERISA provides that a fiduciary must act "(A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries;" *29 U.S.C. § 1104*(a)(1)(A), ERISA does no more than protect the benefits which are due to an employee under a plan.

Appendix A

It is true that appellants' level of benefits was contingent on the performance of Conrail securities purchased for their individual accounts, based on their level of contribution. As the value of those securities went up, so did the value of their accounts. Accordingly, appellants realized the increase in value of those securities while appellants were participants in the Plan. However, ERISA only guarantees them the level of the benefits accrued up to the time of their termination by Conrail. For this reason, the windfall, from which they claim they were excluded, was not one to which they were entitled.

Moreover, appellants overstate the magnitude of the so-called windfall. The distribution of the cash surplus can only be made up to the limit allowed by the tax code. This is the lesser of 25% of an employee's salary or $30,000. Since many of the employees who receive this "windfall" will lose their jobs as a result of the CSX-Norfolk Southern takeover, the amount of their windfall hardly seems inequitable.

Even if we conclude then that a partial termination did occur as a result of the layoffs at Conrail, ERISA protects only accrued benefits. These were credited to appellants in the form of the balance of the individual accounts guaranteed to appellants when they were laid off. Appellants are not entitled to the surplus that resulted from the tender offer.

Appendix A

B. Complete Termination of the Plan and Application of § 1344

We now turn to the application of *29 U.S.C. § 1344* to a complete termination of the Plan. Appellants assert that, even if no partial termination occurred, they were entitled to share in the surplus when Conrail completely terminated the Plan in May 1997. They argue that § 1344(d) governs the distribution of residual assets when a plan is terminated and that, pursuant to its language, former employees should share in the surplus.

Appellants point out that ERISA directs that a plan termination be conducted according to the procedure set forth in § 1344. Section 1103(d) provides that "upon termination of a pension plan . . . the assets of the plan shall be allocated in accordance with the provisions of section 1344 . . . ." *29 U.S.C. § 1103*(d)(1). Section 1103(d)(2) further provides that a plan's assets shall be distributed "in accordance with the terms of the plan."

Section 1344(d) regulates the distribution of residual assets to the employer after the satisfaction of all liabilities to plan participants. It reads in part:

> (1) Subject to paragraph (3), any residual assets of a single-employer plan *may be distributed to the employer* if —
>
> (A) all liabilities of the plan to participants and their beneficiaries have been satisfied,

(B) the distribution does not contravene any provision of law, and

(C) the plan provides for such distribution in these circumstances.

* * *

(3)(A) Before any distribution from a plan pursuant to paragraph (1), if any assets of the plan attributable to employee contributions remain after satisfaction of all liabilities described in subsection (a) of this section, such remaining assets shall be equitably distributed to the participants who made such contributions or their beneficiaries (including alternate payees, within the meaning of section 1056(d)(3)-(K)) of this title.

29 U.S.C. § 1344(d) (emphasis added).

Appellants are correct that ERISA directs that a plan termination be conducted in accord with § 1344 and that § 1344(d) governs the distribution of residual assets. Appellants argue that, since ERISA defines "participants" to include employees and former employees, *29 U.S.C. § 1002*(7), appellants should be included in the allocation described in § 1344(d). The plain language of § 1344(d), however, proves the error of their argument. Section 1344(d) applies only when an employer is seeking a reversion of assets to itself. *29 U.S.C. § 1344*(d)(3)(A). That is not the case here. Appellants concede that the Plan contains no

employer reversion provision. In addition, § 1344(d) refers to the distribution of residual assets "attributable to employee contributions." This case, however, involves the distribution to participants of a surplus resulting from a favorable tender offer, not a distribution of the remainder of their contributions. For these reasons, we conclude that § 1344 does not entitle appellants to a share of the surplus assets.

Finally, appellants argue that in amending the Plan to create the distribution scheme now under attack, Conrail violated its fiduciary duties to act with loyalty and impartiality. ERISA basically requires that fiduciaries comply with the plan as written unless it is inconsistent with ERISA. *29 U.S.C. § 1104*(1)(D). *Chait v. Bernstein, 835 F.2d 1017 (3d Cir. 1987)* (receiver who took over management of corporation that contributed to plan did not self-deal when he terminated the plan in accord with ERISA.) Essentially, appellants claim that Conrail's actions inure to the benefit of management and to the exclusion of plan participants in direct contravention of ERISA. Because we find that appellants are not entitled to any of the surplus either upon partial termination or complete termination, we find appellants lack standing to challenge the manner in which that surplus is ultimately distributed. In short, they are not harmed by the distribution scheme.[6]

---

6. Since appellants lack standing to challenge the distribution scheme, we will take no position at this time whether the scheme is in accord with ERISA.

Appendix A

C. Fiduciary Duty

The second count of the dismissed complaint makes a claim of breach of fiduciary duty by Conrail. Appellants argue that, when terminated, the Plan became a "wasting trust"[7] and as a consequence Conrail had an obligation under common law to distribute all the assets equitably. Conrail contends that its actions in amending the Plan were not those of a fiduciary under ERISA.

ERISA imposes fiduciary duties in the administration of plans which it governs. *American Flint Glass Workers Union v. Beaumont Glass Co., 62 F.3d 574, 579 (3d Cir. 1995); Walling v. Brady, 125 F.3d 114, 118-19 (3d Cir. 1997).* We have recognized, however, that ERISA permits employers to "wear 'two hats'," one as plan administrator, the other as plan sponsor. *Blaw Knox Retirement Income Plan v. White Consol. Indus., 998 F.2d 1185, 1189 (3d Cir. 1993),* quoting, *Payonk v. HMW Indus., Inc., 883 F.2d 221, 225 (3d Cir. 1989).* Fiduciary duties attach to the actions of employers " 'only when and to the extent' that they function in their capacity as plan administrators, not when they conduct business that is not regulated by ERISA." Id.

Under ERISA, an employer has broad authority to amend a plan, *Hughes Aircraft, 1999 WL 24546,* at *5 (holding that where employer "makes a decision regarding

---

7. A "wasting trust" is recognized under common law as a trust that has had its purposes accomplished so that its continuation would frustrate the settlor's intent. See *Hughes Aircraft Co. v. Jacobson, No. 97-1287, 1999 WL 24546,* at *9 (U.S. Jan. 25, 1999).

the form or structure of the plan," ERISA's fiduciary duty requirement is not implicated). In amending a plan, the employer is acting as a settlor. Id.; *Lockheed Corp. v. Spink, 517 U.S. 882, 890, 135 L. Ed. 2d 153, 116 S. Ct. 1783 (1996).* There are portions of ERISA which govern plan amendments; for example, under § 1054(g), an amendment may not decrease accrued benefits. However, as long as an amendment does not violate a specific provision of ERISA, "the act of amending a pension plan does not trigger ERISA's fiduciary provisions." See *Hughes Aircraft, 1999 WL 24546,* at *5. Thus, the mere fact that Conrail amended its Plan did not breach any fiduciary duties under ERISA.

With regard to appellants' wasting trust argument, because ERISA is a "comprehensive and reticulated statute" and is "enormously complex and detailed," it should be supplemented by the common law only where ERISA does not address an issue. See *Hughes Aircraft, 1999 WL 24546,* at *6; *Jordan v. Fed. Express Corp., 116 F.3d 1005, 1017-18 (3d Cir. 1997).* Moreover, even if we were to invoke the common law, the Plan was not a wasting trust. The Plan itself provided for its termination and the distribution of its assets. The District Court found that the Plan could not be likened to a wasting trust because it was an active plan up until just six months prior to the filing of this suit. Thus, appellants' fiduciary duty arguments under their common law claim must fail.

IV. CONCLUSION

For the reasons stated above, we will affirm the judgment of the District Court.

APPENDIX B — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA DATED AND FILED OCTOBER 30, 1997 AND ENTERED OCTOBER 31, 1997

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

STEVEN W. BENNETT, et al. v. CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE, et al.; JOANNE KELLY, et al. v. CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE, et al.; GEORGE E. GALE, III, et al. v. CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE, et al.

CIVIL ACTION NO. 97-4535, CIVIL ACTION NO. 97-5017, CIVIL ACTION NO. 97-5345

* * *

Bartle, J.

October 30, 1997

These three related purported class actions involve a dispute over the distribution of some $533 million in surplus assets in a terminated Employee Stock Ownership Plan ("ESOP"). An ESOP is an individual account plan which invests in "qualifying employer securities." *Kuper v. Iovenko, 66 F.3d 1447, 1457 (6th Cir. 1995).*

Appendix B

The plaintiffs are former employees of Consolidated Rail Corporation ("Conrail") who have participated in the ESOP.[1] They have sued the Conrail Matched Savings Plan ("Plan"), its Administrative Committee, which is the statutory administrator of the Plan, and the individuals comprising the Administrative Committee. The plaintiffs allege that the defendants have breached fiduciary duties imposed by the Employee Retirement Income Security Act ("ERISA"), *29 U.S.C. §§ 1001* et seq., through their failure to comply with federal laws, specifically ERISA and the Internal Revenue Code, in their allocation of the ESOP surplus. The current scheme would distribute the surplus ESOP assets to those who were Conrail employees in 1996, 1997, and 1998. Presently before the court is the motion of the defendants to dismiss the complaints pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to state a claim upon which relief can be granted.

A motion to dismiss for failure to state a claim should only be granted if "it is clear that no relief could be granted under any set of facts that could be proved consistent with

---

1. In the Bennett and Kelly complaints, the class is defined as "All persons who are current or former participants or beneficiaries of the ESOP portion of the Conrail Matched Savings Plan and who are no longer employed by Conrail." Bennett Compl. P 12; Kelly Compl. P 8. The Gale complaint specifies the class as "all persons who were participants in 1996 in the Employee Stock Ownership Plan ('ESOP') portion of the Consolidated Rail Corporation Matched Savings Plan ('Plan') and who are no longer employed by Consolidated Rail Corporation ('Conrail') nor eligible to participate in the Non-Agreement Severance Package announced by Conrail in March, 1997." Gale Compl. P 8.

the allegations" contained in the complaint. *Hishon v. King & Spalding, 467 U.S. 69, 73, 81 L. Ed. 2d 59, 104 S. Ct. 2229 (1984).* All allegations in plaintiffs' complaints are accepted as true, and we must draw any reasonable inferences from such allegations in plaintiffs' favor. *Oshiver v. Levin, Fishbein, Sedran & Berman, 38 F.3d 1380, 1391 (3d Cir. 1994).* A court may consider documents not formally attached to the complaint in deciding a 12(b)(6) motion to dismiss, when allegations in the complaint are based on those documents and authenticity is unchallenged. *In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1426 (3d Cir. 1997).*

I

In March, 1990, Conrail established the ESOP at issue as a separate portion of a voluntary employee savings plan for the benefit of non-union employees, pursuant to § 401(k) of the Internal Revenue Code. The ESOP is governed by ERISA. That statute was enacted to "ensure that bona fide employees with long years of employment and contributions realize anticipated pension benefits." *Reuther v. Trustees of the Trucking Employees of Passaic and Bergen County Welfare Fund, 575 F.2d 1074, 1077 (3d Cir. 1978).* The ESOP at issue in this case is a defined contribution plan, also known as an individual account plan, under ERISA. Such a plan is described as "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account." *29*

U.S.C. § 1002(34). According to the United States Supreme Court, under defined contribution plans "employees are not promised any particular level of benefits; instead, they are promised only that they will receive the balances in their individual accounts." *Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633, 637 n.1, 110 L. Ed. 2d 579, 110 S. Ct. 2668 (1990).* In other words, the employee only receives the benefit of what he or she or the employer contributed. The value of the account is subject to the vagaries of the marketplace. If the value of the shares held in the participant's individual account increases, it is probable that the level of benefits will do so also. If the value decreases, the benefits will likely decrease.

The other type of plan under ERISA is a "defined benefit plan," defined as "a pension plan other than an individual account plan." *29 U.S.C. § 1002*(35). In contrast to a defined contribution plan, a defined benefit plan is one where the benefit to be received is fixed. *Pension Benefit, 496 U.S. at 637 n.1.*

According to the complaints[2] and the Consolidated Rail Matched Savings Plan ("Plan Agreement"), the ESOP borrowed funds with which it purchased a special class of preferred Conrail stock.[3] The purchase, which constituted

2. The facts recited here are from the Bennett complaint. However, the allegations of the other two complaints are nearly identical. The three classes of plaintiffs have also responded jointly to defendants' motion to dismiss.

3. According to the defendants, Conrail loaned the funds to the ESOP. However, this fact is not stated in the complaints or the Plan Agreement.

a 10% ownership interest in the company, was held in an unallocated stock account. Plan Agreement at P 7.2; Compl. PP 25, 38. If an eligible employee voluntarily requested that a portion of his or her compensation be placed into the Plan, Conrail then matched the employees' salary deferral "in an amount not to exceed 6% of salary, with allocations of the Conrail preferred stock held in the ESOP" from the unallocated stock account. Compl. P 26; see also Plan Agreement at P 4.4(b). Under the terms of the Plan, the allocation of Conrail's matching stock contribution was to be made at least annually to the individual account for each participant. Plan Agreement at PP 4(a), 7.2(b). Moreover, "all amounts allocated to the Account of a Participant shall be fully vested and nonforfeitable at all times." Plan Agreement at P 12.1.

Shortly after Conrail instituted the ESOP, it began involuntarily terminating employees as well as encouraging the early retirement of others. To date, plaintiffs estimate that 2,000 employees who formerly participated in the ESOP are no longer working for Conrail. In accordance with the Plan, a terminated ESOP participant is "entitled to a distribution of all amounts credited to his [or her] account." Plan Agreement at P 8.1.

Conrail is now in the midst of a takeover. On April 8, 1997, CSX Corporation and Norfolk Southern Corporation agreed to form a new entity to acquire Conrail. Pursuant to this takeover agreement, a tender offer was made for all the outstanding shares of Conrail stock, including the shares of preferred stock held in the ESOP, for a price of $115 per share. This tender offer was completed on June 2, 1997, and the cash proceeds from the preferred stock were

deposited into the ESOP. As of that date, Conrail ceased being a publicly traded company.

As a result of the impending takeover, Conrail announced in March, 1997 that the ESOP would be discontinued, effective May 22, 1997. However, as of April 30, 1997, employees could no longer make contributions to the Plan, and the Conrail matching contributions ceased.

While the ESOP formerly held almost 10 million shares of Conrail preferred stock, only 2.7 million had been "irrevocably allocated to ESOP participants" as of December 31, 1996. Compl. P 38. The tender offer created in the ESOP a cash surplus not allocated to individual employee accounts. The amount of these undesignated assets, after repayment of the loan used to fund the ESOP, total approximately $533 million.

On June 11, 1997 in the Third Amendment to the Plan Agreement, Conrail announced that it would allocate all of the $533 million surplus to those who were employees of Conrail in 1996, 1997, and 1998. The allocations will consist of "an additional amount representing the maximum possible allocation under tax regulations" for those calendar years. Compl. P 39. According to paragraph (14) of the Third Amendment, these allocations are capped annually at the lesser of $30,000 or 25% of annual compensation for each eligible employee. These allocations are estimated to be sufficient to deplete the entire surplus.[4] Compl. P 39.

---

4. Once the takeover of Conrail is completed, its assets will be divided between CSX and Norfolk Southern, and its Philadelphia office will be closed. As a result, most of its current employees will lose their jobs. Compl. P 37.

Appendix B

Employees who were separated from employment with Conrail, for whatever reason, prior to 1996 will not share in the distribution of the surplus. Plaintiffs aver that the Plan, as amended, illegally discriminates against those who will not participate. They also contend that it favors "disproportionately [ ] highly compensated and senior management who will also receive enhanced bonus and incentive pay . . . , to the detriment of plaintiffs and other ESOP participants who are no longer employed by Conrail." Compl. P 39.

The Plan Agreement provided that it was Conrail's responsibility "to amend or terminate, in whole or in part, the Plan." Plan Agreement at P 13.1. It allowed Conrail, through its Board of Directors,

> to amend the Plan at any time and in any manner, without prior notification, consultation, or bargaining with any Employee or representative of Employees. To the extent required by the [Internal Revenue] Code, no amendment to the Plan shall decrease a Participant's benefit or eliminate an optional form of distribution. No amendment shall make it possible for any assets of the Plan to be used for or diverted to any purposes other than for the exclusive benefit of Participants and Beneficiaries.

Plan Agreement at P 14.1.

In contrast, the role of the Administrative Committee was to administer the Plan. It had the authority to "adopt

any ministerial and nonsubstantive amendment it deems necessary or appropriate to (a) facilitate the administration, management and interpretation of the Plan, [or] (b) conform the Plan to current practice." Plan Agreement at P 14.2.

II

The complaints set forth two counts. Under Count 1 plaintiffs allege that defendants have violated their fiduciary duties imposed under ERISA, *29 U.S.C. §§ 1104*(a) and 1105(a), in connection with the partial and complete terminations of the ESOP. Defendants counter that they have complied with the applicable law.

ERISA sets forth standards with which a Plan fiduciary such as the Administrative Committee must comply. See *29 U.S.C. §§ 1104*(a), 1105(a). Specifically, a fiduciary must act "(A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan." *29 U.S.C. § 1104*(a)(1)(A). The fiduciary must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." Id. § 1104(a)(1)(B). Further, a fiduciary must carry out its responsibilities according to the rules set forth in the Plan Agreement, unless doing so would be inconsistent with an ERISA provision. Id. § 1104(a)(1)(D). Section 1105(a) sets forth the circumstances under which a fiduciary will be held accountable for the acts of his or her co-fiduciary. Specifically, a co-fiduciary is jointly liable if he or she

knowingly participates in, conceals, enables, or has knowledge of another's breach of fiduciary duties under § 1104. *29 U.S.C. § 1105*(a).

Plaintiffs claim that the severe reduction of employees participating in the ESOP in the years 1990 to 1996 resulted in a partial termination of the ESOP. According to plaintiffs, the law governing the distribution of assets upon a partial termination required that defendants, as ERISA fiduciaries, distribute the surplus to former as well as current Conrail employees.

A partial termination of an employee benefit plan "involves a significant reduction in plan liability by means of a corresponding reduction in employee benefits." *Gluck v. Unisys Corp., 960 F.2d 1168, 1183 (3d Cir. 1992).* "Events such as mass firing or lay-offs due to closing divisions or moving plants, or other employee 'turnover,' " may constitute a partial termination. Id. (internal citations omitted). Whether or not a partial termination has occurred is determined by weighing the "facts and circumstances" in each particular case. *Id. at 1184.* Internal Revenue rules and regulations are relevant considerations in determining whether a partial termination occurred, although they are not binding because a "partial termination for tax purposes is not necessarily a termination or partial termination for ERISA purposes." Id.

Viewing the facts in a light most favorable to the plaintiffs, we will assume that a partial termination did in fact occur during the mass terminations and early retirements beginning in 1990. The remaining issue is

whether, assuming there was a partial termination, the plaintiffs would be entitled under ERISA to a share of any surplus that may have existed at that time.[5]

Plaintiffs cite § 411(d)(3) of the Internal Revenue Code and its accompanying regulations in support of their argument that they are entitled to the Plan surplus. The Internal Revenue Code sets forth the minimum standards that a trust must meet in order to be deemed "qualified" under the tax laws and receive tax exempt status. See I.R.C. §§ 401, 501. If a trust is not deemed qualified, the employees must pay taxes on the contributions made by the employer on the employees' behalf. Treas. Reg. § 1.402(b)-1. Plaintiff contends that if the fiduciary acts in such a way as to cause the employees to pay a tax, a breach of fiduciary duty under ERISA has occurred.

The tax provision relied upon by plaintiffs provides in pertinent part:

> (3) Termination or partial termination; discontinuance of contributions. — Notwithstanding the provisions of subsection (a),

---

5. Plaintiffs rely on a Third Circuit case, *Delgrosso v. Spang and Co., 769 F.2d 928, 938 (3d Cir. 1985)*, cert. denied, *476 U.S. 1140, 90 L. Ed. 2d 692, 106 S. Ct. 2246 (1986)*, which required a pro rata allocation of a surplus "according to the ratio of each participant's accrued benefits to the sum of all accrued benefits." However, this case relied on an ERISA Regulation now repealed, 29 C.F.R. § 2628.32(a). While plaintiffs contend that we must rely on this regulation as the best evidence of what Congress intended employers to do with pension surplus assets, we decline to do so.

> a trust shall not constitute a qualified trust under section 401(a) unless the plan of which such trust is a part provides that —
>
> > (A) upon its termination or partial termination, or
> >
> > (B) in the case of a plan to which section 412 does not apply, upon complete discontinuance of contributions under the plan,
>
> the rights of all affected employees to benefits accrued to the date of such termination, partial termination, or discontinuance, to the extent funded as of such date, or the amounts credited to the employees' accounts, are nonforfeitable.

I.R.C. § 411(d)(3) (emphasis added). For a defined contribution plan such as involved here, the "benefits accrued" referred to above means the balance in the individual's account. See I.R.C. § 411(a)(7)(A)(ii); *29 U.S.C. § 1002*(23)(B).

The Court of Appeals for the Third Circuit has interpreted § 411(d)(3) to require vesting of benefits upon a termination or partial termination of a Plan "to ensure that employees get their expected benefits." *Gluck v. Unisys Corp., 960 F.2d 1168, 1182 (3d Cir. 1992); Ashenbaugh v. Crucible Inc., 854 F.2d 1516, 1525 (3d Cir. 1988),* cert. denied, *490 U.S. 1105, 104 L. Ed. 2d 1019, 109 S. Ct. 3155 (1989); Chait v. Bernstein, 835 F.2d 1017, 1021 (3d Cir.*

1987). The relevant Internal Revenue Code Regulation under § 411 states that in the event of a partial termination, a plan must "provide[] for the allocation of any previously unallocated funds to the employees covered by the plan upon the termination or partial termination of the plan." Treas. Reg. § 1.411(d)-2(a)(2)(i). However, this Regulation does "not require the allocation of amounts to the account of any employee if such amounts are not required to be used to satisfy liabilities with respect to employees and their beneficiaries." Id. § 1.411(d)-2(a)(2)(iii). According to the Third Circuit, these tax rules "serve the purpose of helping to ensure that employees will not be deprived of their anticipated benefits." *United Steelworkers of America v. Pension Benefit Guar. Corp., 706 F.2d 1289, 1298 (3d Cir. 1983).*

In *Chait v. Bernstein*, the Third Circuit held that "the purposes and policies of partial terminations under the tax code do not apply in the context of vested employees attempting to gain plan *surplus*." *835 F.2d at 1021* (emphasis added). There, the employees and the employer were battling over ownership of surplus assets remaining in the company's defined benefit pension plan, after all vested benefits had been paid. *Id. at 1018.* The employer argued that the surplus assets reverted to it because it had funded the entire plan, and had adopted an amendment providing for reversion in the event of a surplus. *Id. at 1018-19.* The court held that § 411(d)(3) worked only to vest, or make non-forfeitable, an employee's "anticipated benefits" and "should not be extended to apply to surplus assets, after vested benefits are provided for, in a defined benefit plan." *Id. at 1021.* The court concluded that the amendment to the

Plan, providing for reversion to the employer, was valid. *Id. at 1023-24.* Because the employees would receive all the benefits to which they were entitled under the Plan, and neither the employees nor the employer had ever expected a surplus, the court found no reason to preclude the surplus from reverting to the employer. *Id. at 1026.*

We recognize that this case involved a defined benefit plan where only the employer and not the employees had made contributions to it. We also concede that the Court of Appeals emphasized that its holding was limited to the facts of that case. Nonetheless, we find its reasoning persuasive here. Like *Chait*, it appears that under the provisions of the Plan Agreement, the plaintiffs have received, or will receive, all the benefits to which they were entitled. The surplus here simply was not an "anticipated benefit." Even more compelling, unlike the employer in *Chait*, Conrail is not seeking to recapture the assets for itself but rather to distribute them to its remaining active employees, who are ESOP participants.

Section 411(d)(3), its regulations, and the relevant case law, do not support plaintiffs' claim that they are entitled to share the Plan surplus under ERISA. Because the Plan Agreement provides for the immediate vesting of benefits, Internal Revenue Code § 411(d)(3) has been met. All ESOP participants, now no longer employed by Conrail, will receive the balance of their accounts. Such rights are made non-forfeitable by the Plan Agreement itself. As the Third Circuit stated,

Appendix B

> Section 411(d)(3) . . . [is] thus [a] vesting provision[] only. As such, [it has] nothing whatever to do with the rights of fully vested employees like the plaintiffs in this case, and we are at a loss to understand plaintiffs' argument that these provisions somehow require the Plan to give them benefits they do not claim are provided by the other terms of the Plan.

Ashenbaugh, 854 F.2d at 1525.[6]

Plaintiffs also claim that defendants have violated their fiduciary duty under ERISA by failing to comply with *29 U.S.C. § 1344*. According to plaintiffs, this portion of ERISA, which governs the distribution of Plan assets, applies in the event of a partial termination.

We note initially that § 1344 by its terms is limited to a "single-employer defined benefit plan," not a defined contribution plan, which is at issue here. However, in *29 U.S.C. § 1103*(a)(1), ERISA states that when a pension plan (defined in *29 U.S.C. § 1002*(2)(A) to include a defined contribution plan) is terminated, *29 U.S.C. § 1344* governs the distribution of plan assets. Section 1344 provides in relevant part:

> (d) Distribution of residual assets; restrictions on reversions pursuant to recently amended

6. Our holding is consistent with a case substantially similar to the instant dispute. See *Rummel v. Consolidated Freightways, Inc., 1992 U.S. Dist. LEXIS 15144, No. CIV. A. C-91-4168 DLJ, 1992 WL 486913* (N.D. Cal. Sept. 17, 1992).

plans; assets attributable to employee contributions; calculation of remaining assets

(1) Subject to paragraph (3), any residual assets of a single-employer plan may be distributed to the employer if —

(A) all liabilities of the plan to participants and their beneficiaries have been satisfied,

(B) the distribution does not contravene any provision of law, and

(C) the plan provides for such a distribution in these circumstances.

. . .

(3)(A) Before any distribution from a plan pursuant to paragraph (1), if any assets of the plan attributable to employee contributions remain after satisfaction of all liabilities described in subsection (a) of this section, such remaining assets shall be equitably distributed to the participants who made such contributions or their beneficiaries (including alternate payees, within the meaning of section 1056(d)(3)(K)) of this title.

29 U.S.C. § 1344(d).

According to the Third Circuit, this provision does not apply to partial terminations, unless the Plan Agreement specifically states that it shall apply to partial terminations. *Ashenbaugh, 854 F.2d at 1529 n.15;* accord *Van Orman v. American Ins. Co., 680 F.2d 301, 313 (3d Cir. 1982).* Here, there is no provision in the Plan Agreement for the application of § 1344 to a partial termination of the Plan. Therefore, assuming that a partial termination of the ESOP occurred, this section affords no relief to the plaintiffs.

While the plaintiffs focused primarily on a partial termination, and the laws that would apply, they also seem to suggest that at the time of the full termination in 1997 they were entitled to a share of the surplus. As we discussed above, § 411(d)(3) does not entitle plaintiffs to share the ESOP surplus.

We next examine whether § 1344 of ERISA, quoted above, enables plaintiffs to claim a portion of the surplus upon a full termination of the ESOP. This section, specifically § 1344(d), is applicable to full terminations and refers to the distribution of residual assets.

Plaintiffs contend that the allocation described therein includes allocations to former employees, because ERISA defines "participants" to include employees and former employees. *29 U.S.C. § 1002*(7). We do not dispute this contention. However, the plain language of the statute suggests that § 1344(d) only applies in the event of, and prior to, a reversion of the surplus to the employer. *29 U.S.C. § 1344*(d)(3)(A). The preface of section (d) of the statute states "before any distribution from a plan pursuant to

paragraph (1) [reversion to employer] . . . such remaining assets shall be equitably distributed to the participants." Id. By the terms of the statute, an employer is only required to distribute surplus to its employees prior to a reversion to itself. If no employer reversion is sought, we see no requirement at all to distribute any surplus or residual assets to all employees, present and former. Our reading of the statute is bolstered by the legislative history to this provision. It indicates that "the Committee believes it is unfair to permit the complete recapture by employers of surplus funds in terminated contributory plans, without regard to the fact that contributions by the workers helped to generate the surplus." S. Rep. No. 93-127, at 30, reprinted in 1974 U.S.C.C.A.N. 4838, 4866 (emphasis added).

Moreover, pursuant to § 1344, only those assets remaining which are "attributable to employee contributions" need be distributed among plan participants. Id.; *Morales v. Pan American Life Ins., 914 F.2d 83, 87 (5th Cir. 1990).* In this case, the complaint does not allege that any surplus was attributable to employee contributions. As such, plaintiffs have not alleged a basis for relief under § 1344(d).

As a final argument to avoid dismissal of Count 1, plaintiffs contend that defendants have violated the fiduciary duty under ERISA because the proposed distribution of surplus assets discriminates in favor of highly compensated employees. Plaintiffs assert that such a distribution will violate the Internal Revenue Code and Treasury Regulations prohibiting such allocations. I.R.C. § 401(a)(4); Treas. Reg. § 1.411(d)-2(a)(ii). According to plaintiffs, this issue can

only be resolved after determination of facts and circumstances and therefore is not proper to resolve on a motion to dismiss. Plaintiffs further maintain that the defendants who are members of the Administrative Committee have acted for an improper motive of personal gain, because they also will receive allocations of the surplus pursuant to the Plan Amendment. However, because we have decided that under applicable law the plaintiffs have no right to the surplus, even if a partial or full termination occurred, they have no standing to challenge its eventual distribution. If any discrimination occurred, it was not these plaintiffs that were hurt.

In summary, the duties imposed by ERISA require that the fiduciaries comply with the Plan, unless that plan is inconsistent with an ERISA provision. *29 U.S.C. § 1104*(1)(D). The fiduciaries here complied with the Plan Agreement and as far as we can determine such Agreement was consistent with ERISA. Under the Plan Agreement, upon termination of employment each employee was only "entitled to a distribution of all amounts credited to his [or her] Account." Plan Agreement at P 8.1. The Plan Agreement also provided that the Board of Directors and the Administrative Committee could amend the Plan. Plan Agreement at PP 14.1, 14.2. Conrail did so, adopting an amendment regarding the distribution of the surplus. Count 1 of the complaints fails to state a claim upon which relief can be granted.[7]

---

7. Plaintiffs also argue in their sur reply brief that Conrail is bound to distribute Plan surplus to employees because it told them in 1996 it would prorate the surplus according to account balances. (Cont'd)

Appendix B

III

Under Count 2 of the complaints, plaintiffs allege that defendants again breached the fiduciary duties under ERISA when they failed upon termination of the ESOP to distribute the surplus assets equitably. Plaintiffs aver that since the ESOP was discontinued, it is a wasting trust and defendants must distribute all its assets, including the surplus, in a fair and equitable fashion. Defendants disagree. They argue in opposition to Count 2 that the common law invoked by plaintiffs is irrelevant and that in any event the actions taken by Conrail were corporate decisions, not subject to the fiduciary duties imposed by ERISA.

We agree with defendants that not all actions by an employer in conjunction with a pension plan are governed by ERISA. In *American Flint Glass Workers Union v. Beaumont Glass Co., 62 F.3d 574, 578 (3d Cir. 1995),* the Third Circuit observed that "although 'ERISA created a fiduciary duty on the part of an employer administering a

---

(Cont'd)

In support of this statement, plaintiffs cite the complaint of yet another class action against Conrail, *Bunnion v. Consolidated Rail Corp.*, Civ.A. No. 97-4877, at P 52. This allegation is not contained in any of the three complaints we address here. Moreover, no law or precedent cited by plaintiffs indicates that this alleged representation by Conrail is enough to change the terms of the Plan. Conrail as settlor had the right to amend its Plan any way it desired. Further, in a more extreme case, the Third Circuit found no violation of fiduciary duties where a company adopted a resolution to terminate its Plan and then later decided it would not do so. *American Flint Glass Workers Union v. Beaumont Glass Co., 62 F.3d 574, 576 (3d Cir. 1995).*

plan,' the employer does not always act in a fiduciary capacity." An employer's decision to amend or terminate the Plan is not subject to a fiduciary duty and thus the standards imposed by ERISA do not apply. *Id. at 578-79;* accord *Lockheed Corp. v. Spink, 135 L. Ed. 2d 153, 116 S. Ct. 1783, 1789-90 (1996).*

This is true even if a plan amendment appears unfair, or does not affect all participants similarly. In *Walling v. Brady, 119 F.3d 233, 1997 WL 545795,* at *1 (3d Cir. 1997), the Board of Trustees of a defined benefit pension plan, upon finding it had a surplus, amended the pension plan agreement to "pay[] an additional $100 per month in benefits to those members of the Pension Fund who, by virtue of also being members of the Welfare Fund, would now have to pay $100 each month to the Welfare Fund." The benefits to the other plan members were not reduced. Id. The plan members who were not also members of the Welfare Fund sued. They contended that the surplus should have been equally distributed among all participants or retained in the pension fund. Id. at *2. The Third Circuit held that no fiduciary duty applied because "the Trustees acted within their powers as settlors in amending the Pension Fund plan." Id. Similarly, Conrail as settler of the Plan amended it to provide for the distribution of its surplus assets. In so doing, it was not acting as a fiduciary and therefore the fiduciary standards of ERISA were inapplicable.

ERISA generally preempts all state law which affects a pension plan. *29 U.S.C. § 1144*(a). We may apply federal common law, "only if ERISA does not expressly address the issue and the common law rule is consistent with the

underlying purposes of ERISA." *In re Gulf Pension Litig., 764 F. Supp. 1149, 1202 (S.D. Tex. 1991)*, aff'd sub nom. *Borst v. Chevron Corp., 36 F.3d 1308 (5th Cir. 1994)*, cert. denied, *514 U.S. 1066, 131 L. Ed. 2d 561, 115 S. Ct. 1699 (1995)*. The Court of Appeals for the Third Circuit has held that federal common law shall only be used for cases involving pensions plans covered by ERISA when "necessary to fill in interstitially or otherwise effectuate the statutory pattern enacted in the large by Congress." *Jordan v. Federal Express Corp., 116 F.3d 1005, 1017-18 (3d Cir. 1997)*. Moreover, courts should be hesitant to create "additional ERISA claims . . . under the guise of federal common law." *Id. at 1018*. In Jordan, the Third Circuit held that a claim for unjust enrichment was not needed to effectuate ERISA. Id.

Plaintiffs invoke the common law of a wasting trust. A wasting trust, also called a dry trust, is one whose material purpose has been fulfilled. *Gulf, 764 F. Supp. at 1202*. In Gulf, a wasting trust was expanded upon as follows:

> At common law if a trust did not state a definite term, it was deemed to last until its purpose was accomplished. Once the object of the settlor had been achieved, the trust was deemed to end since its continuation would be useless and might frustrate the intent of the settlor to a beneficiary or remainder interest.

Id.[8]

---

8. Black's Law Dictionary defines a wasting trust as a "trust, the res of which consists in whole or in part of property which is

(Cont'd)

Appendix B

The United States District Court for the Southern District of Texas held that the concept of a wasting trust could be applied to a trust otherwise governed by ERISA. *Gulf, 764 F. Supp. at 1202.* In *Gulf*, the plans at issue had stopped accepting employee and employer contributions over 20 years ago. *Id. at 1203.* The court found that the purpose of the trust had long been fulfilled, the plan was substantially over funded, and was not benefitting anyone by remaining intact. *Id. at 1203-04.* "These plan members and beneficiaries, most of whom are retired, are getting older with each passing day, and prolonging the plans means that ever fewer participants will have the opportunity to enjoy the benefits of the plan surpluses." *Id. at 1204.*

Unlike *Gulf*, the ESOP in issue here had been an active plan until six months ago, when Conrail was sold and the ESOP was terminated. The Plan could hardly be described as "wasting" since provisions have been made for its distribution in the near future. Moreover, ERISA already provides for procedures in the termination of a Plan, and the Plan Agreement itself provides for the distribution of the surplus. Applying the law of a wasting trust would not fill a gap in ERISA and would not effectuate any ERISA provision. *Jordan, 116 F.3d at 1017-18.* We decline the plaintiffs' invitation to create new federal common law.

(Cont'd)

gradually being consumed (i.e. consisting of wasting assets)." A dry trust is "one which merely vests the legal title in the trustee, and does not require the performance of any active duty on his part to carry out the trust." Id. We could find nothing in the Restatement of Trusts, and the parties cite nothing, which expanded upon the concepts behind these trusts.

Count 2 also fails to state a claim upon which relief can be granted.

IV

In conclusion, the plaintiffs are not being cheated out of any money which they contributed to or were promised under the Plan Agreement. This is not a case where Peter is being robbed to pay Paul. Simply because others may be receiving more than they had anticipated does not give plaintiffs a claim for relief.

The motions of the defendants to dismiss plaintiffs' complaints will be granted.[9]

---

9. In their brief in support of their motion to dismiss, defendants claimed that under I.R.C. § 415, Conrail could only distribute surplus to current, and not former, employees. They alleged that failure to comply with this provision would have subjected all current and former ESOP participants to tax on all prior Conrail contributions. Because of our resolution of the motion to dismiss, we need not address this argument.

Appendix B

ORDER

AND NOW, this 30th day of October, 1997, for the reasons set forth in the accompanying Memorandum, the motion of defendants Conrail Matched Savings Plan Administrative Committee, Deborah A. Melnyk, John/Jane Does 1-10, and Consolidated Rail Corporation Matched Savings Plan to dismiss the complaints of plaintiffs is GRANTED.

BY THE COURT:

Harvey Bartle, III

J.

APPENDIX C — CLASS ACTION COMPLAINT

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION NO. 97-CV-4535

STEVEN W. BENNETT, EDMUND L. GILLOOLEY, JOSEPH L. ALESSANDRINI, JR., FRANK W. HEWITT, RICHARD E. SEMERAD, AND WARREN E. KAYLOR, individually and on behalf of all others similarly situated,

Plaintiffs,

v.

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE, DEBORAH A. MELNYK, JOHN/JANE DOES 1-10, AND CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN,

Defendants.

CLASS ACTION COMPLAINT

This action is brought by separated employees of Consolidated Rail Corporation ("Conrail") who are current or former participants in the Employee Stock Ownership Plan ("ESOP") portion of the Consolidated Rail Corporation Matched Savings Plan. This action seeks declaratory and injunctive relief to compel the fiduciaries of the Plan to comply with their duties under ERISA, the Internal Revenue Code and the documents governing the Plan. As a result of

the takeover of Conrail by CSX Corporation and Norfolk Southern Corporation, Conrail will soon cease to exist and the great majority of the remaining participants in the ESOP will lose their jobs. The assets of the ESOP include at least $533 million in unallocated assets. The relief sought by this Complaint ensures that these assets will be distributed fairly and equitably to plaintiffs and the Class — the thousands of men and women who rescued freight railroad in the northeastern United States.

JURISDICTION AND VENUE

1. This Complaint arises under Sections 404, 405, and 502(a)(1)(B), 502(a)(2) and 502(a)(3) of ERISA, 29 U.S.C. §§ 1104, 1105, and 1132(a). This Court has jurisdiction over the subject matter of this action by operation of 29 U.S.C. § 1132(e)(1) and 28 U.S.C. § 1331.

2. Venue is proper in this district pursuant to 29 U.S.C. § 1132(e)(2), because the breaches of duty and other violations of law that are alleged have occurred in this district. Conrail is headquartered in this district. The Plan and ESOP are administered in this district. Defendants work and perform their responsibilities with respect to the Plan and the ESOP in this district. Venue is also proper in this district pursuant to 28 U.S.C. § 1391(b), in that the cause of action arises in this district.

PARTIES

3. Plaintiff Steven W. Bennett was employed by Conrail until July 31, 1996. He served Conrail for over 17

years. Before the creation of Conrail and his acceptance of employment with it, he had worked for over 13 years with the Penn Central Railroad and the Chicago and Northwestern Railroad. He left the employ of Conrail due to the company's solicitation and his acceptance of a Voluntary Separation Program in 1996. He is a participant in the ESOP.

4. Plaintiff Edmund L. Gillooley was employed by Conrail until April 30, 1996. He served Conrail for 19 years. Before the creation of Conrail and his acceptance of employment with it, he had worked for 20 years with the Illinois Central Railroad. He left the employ of Conrail due to the company's solicitation and his acceptance of a Voluntary Retirement Program in 1996. He is a participant in the ESOP.

5. Plaintiff Joseph L. Alessandrini, Jr. was employed by Conrail until April 30, 1996. He served Conrail from its creation for 20 years. Before the creation of Conrail and his acceptance of employment with it, he had worked for 9 years with the Reading Railroad. He left the employ of Conrail due to the company's solicitation and his acceptance of a Voluntary Separation Program in 1996. He is a participant in the ESOP.

6. Plaintiff Frank W. Hewitt was employed by Conrail until April 30, 1996. He served Conrail from its creation for 20 years. Before the creation of Conrail and his acceptance of employment with it, he had worked for 11 years with the Erie Lackawanna Railroad. He left the employ of Conrail due to the company's solicitation and his

acceptance of a Voluntary Retirement Program in 1996. He is a former participant in the ESOP.

7. Plaintiff Richard E. Semerad was employed by Conrail until March 31, 1994. He served Conrail from its creation for 18 years. Before the creation of Conrail and his acceptance of employment with it, he had worked for 16 years with the New York Central and Penn Central Railroads. He left the employ of Conrail due to the company's solicitation and his acceptance of an early retirement program in 1994. He is a former participant in the ESOP.

8. Plaintiff Warren E. Kaylor was employed by Conrail until March 31, 1994. He served Conrail from its creation for 18 years. Before the creation of Conrail and his acceptance of employment with it, he had worked for 21 years with the Pennsylvania and Penn Central Railroads. He left the employ of Conrail due to the company's solicitation and his acceptance of an early retirement program in 1994. He is a former participant in the ESOP.

9. Defendant Administrative Committee of the Conrail Matched Savings Plan is the named fiduciary and statutory Administrator of the Plan, including the ESOP. Under the plan document for the Plan, the Administrative Committee has the sole responsibility for the administration of the Plan, including the duty to conform the conduct of the Plan to the duties and requirements of the governing provisions of ERISA and the Internal Revenue Code. These strict duties and requirements include the strict fiduciary duties to act with undivided loyalty; to act solely in the interest of the

participants and beneficiaries of the Plan; to avoid the taint of conflict of interests and self-interest; to comply with the law; and to manage, allocate and dispose the assets of the Plan in a prudent, impartial and non-discriminatory manner.

10. Individual defendants Deborah A. Melnyk, and John/Jane Does 1-10 are believed to be the current members of the Administrative Committee of the Conrail Matched Savings Plan. (Certain members of the Committee are sued as Doe defendants because Conrail representatives have refused to disclose their identities despite requests by plaintiffs and their counsel.) In this capacity, these defendants have and exercise the same strict duties and responsibilities as the Committee with respect to the administration and conduct of the Plan and the ESOP and the allocation and disposition of their assets. These defendants also function as fiduciaries within the meaning of Section 2(21)(A) of ERISA, 29 U.S.C. § 1002(21)(A), and are duty-bound to act with the same undivided loyalty and adherence to law as does the Committee as a whole.

11. Defendant Consolidated Rail Corporation Matched Savings Plan is a defined contribution, individual account retirement savings plan within the meaning of ERISA Section 3(34), 29 U.S.C. § 1002(34). The Plan is named as a defendant to assure that the Court can provide complete relief to plaintiffs and the Class.

CLASS ACTION ALLEGATIONS

12. Plaintiffs and the Class bring this action as a class action pursuant to Rule 23 of the Federal Rules of Civil

Appendix C

Procedure on behalf of a class consisting of: All persons who are current or former participants or beneficiaries of the ESOP portion of the Conrail Matched Savings Plan and who are no longer employed by Conrail ("the Class").

13. The members of the Class are so numerous that joinder of all members of the Class is impracticable. The exact number of Class members is not currently known by plaintiffs, but is believed to be approximately 2000 persons based upon the number of participants and beneficiaries of the Plan periodically reported to the Internal Revenue Service.

14. Common questions of law and fact exist as to all Class members and these questions predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to all Class members are the following:

(a) Whether defendants' actions and failures to act under the circumstances prevailing violate the rights of plaintiffs and the members of the Class;

(b) Whether defendants should be required to take the actions necessary to comply with their fiduciary duties and the law generally;

(c) Whether there has been a partial termination of the ESOP;

(d) Whether the ESOP is a wasting trust whose purposes have been fulfilled; and

(e) Whether plaintiffs and the members of the Class are entitled to the relief prayed for in this Complaint.

15. Plaintiffs are members of the Class and their claims are typical of the claims of the Class.

16. Plaintiffs will fairly and adequately represent the interests of the Class. They have retained counsel with substantial experience in both ERISA and class action litigation on behalf of employees and retirees. Plaintiffs do not have interests that are antagonistic to or in conflict with those whom they seek to represent as Class representatives.

17. Class certification is appropriate under Rule 23(b)(1) of the Federal Rules of Civil Procedure because individual litigation will, as a practical matter, be dispositive of the interests of all members of the Class in the limited fund of unallocated ESOP assets. Certification also is appropriate under Rule 23(b)(2) of the Federal Rules of Civil Procedure because defendants have acted or refused to act on grounds generally applicable to the Class, making appropriate declaratory, injunctive and other equitable relief on a class-wide basis.

18. If necessary, class certification also would be appropriate under Rule 23(b)(3) of the Federal Rules of Civil Procedure. A class action is superior to other available methods for the fair and efficient adjudication of this controversy, since joinder of all members is impracticable. The expense and burden of individual litigation makes it impractical for the members of the Class to pursue

individual litigation to vindicate their rights. Plaintiffs are not aware of any problems that would militate against the maintenance of this action as a class action.

FACTUAL BACKGROUND

A. *The Genesis of Conrail*

19. In the late 1960's and early 1970's, a number of the railroads providing rail freight service in the northeastern and midwestern United States went bankrupt. These bankrupt railroads included the Penn Central, the Reading, the Central of New Jersey, the Erie Lackawanna, the Lehigh and Hudson River, and the Lehigh Valley railroads. The Congress viewed the preservation of this rail freight industry as a matter of vital importance to the national economy, to the communities served by the railroads, and to the thousands of employees whose well-being directly or indirectly depended upon the survival of the rail freight industry. In 1974, by Public Law 93-236, codified at 45 U.S.C. §§ 701 et seq., the Congress nationalized these rail freight lines and led to the creation of Conrail.

20. To assure the success of Conrail, the employees, including plaintiffs, were required to accept cuts in compensation and benefits and/or to forego increases in compensation.

B. *The First Conrail ESOP*

21. Conrail has long had a history of substantial ownership by current and former employees. In November

1978, the Congress conditioned the grant of economic assistance to Conrail on the mandatory creation of an employee stock ownership plan not later than May 1980, which was to own 15% of Conrail. This initial Conrail ESOP was duly established.

22. By the Conrail Privatization Act of 1986, the Congress mandated that Conrail be privatized by means of a public offering of stock for the 85% of the company not owned by the current and former employees through the Conrail ESOP. The legislation also provided that all stock and other assets held by the Conrail ESOP be distributed to both current and former plan participants within 180 days of the initial public offering of Conrail stock. The initial public offering for Conrail occurred on March 26, 1987. On October 1, 1987, all of the assets of the first Conrail ESOP were distributed to active, separated and retired Conrail employees.

C. *Creation of the Current Conrail ESOP*

23. By virtue of the statutes governing it, Conrail, even after becoming a public company in 1987, enjoyed immunity from any hostile takeover. This special statutory protection lasted until April 1, 1990.

24. In anticipation of the expiration of this special protection, the Board of Directors of Conrail adopted a number of measures intended to minimize the possibility of any hostile takeover of the company. One of these was a new employee stock ownership plan. Conrail announced its plan to establish the ESOP in July 1989.

Appendix C

25. The current Conrail ESOP was established on March 26, 1990, six days before the expiration of Conrail's statutory protection from hostile takeover. The ESOP covered only non-unionized employees, the labor organizations representing unionized workers having opted not to participate in this form of benefit. The assets of the new Conrail ESOP consisted of shares of a special class of preferred stock that were issued solely to the ESOP. Non-unionized employees of Conrail thereby became the owners of 10% of the company. Upon the establishment of the ESOP, Conrail management proclaimed that it was "intended to motivate Conrail's employees to increase profitability and will serve to further align employee and shareholder interests." The new ESOP was also portrayed as a replacement for a program of retiree medical benefits, which Conrail prospectively eliminated in July 1990 for employees who then were younger than age 50.

26. The Conrail ESOP was implemented as a separate portion of the Internal Revenue Code section 401(k) voluntary employee savings plan available to non-unionized employees, the Consolidated Rail Corporation Matched Savings Plan. Under the Savings Plan, employees were provided the opportunity to accumulate retirement savings by electing voluntary deferrals of portions of their compensation. Plan participants could not elect to direct their own contributions to the ESOP and Conrail stock. Rather, Conrail matched employees' salary deferrals, dollar for dollar, in an amount not to exceed 6% of salary, with allocations of the Conrail preferred stock held in the ESOP.

Appendix C

D. *The Mass Terminations of Conrail Employees*

27. Beginning in or about 1990, soon after the establishment of the ESOP, Conrail implemented a series of actions to either involuntarily terminate employees who were previously covered by and participating in the ESOP, or to induce resignations or retirements of such participating employees by means of special voluntary retirement and resignation programs.

28. As a result of these actions by Conrail, approximately 2000 ESOP participants have been separated from active employment and active participant status in the ESOP. From 1990 to 1993, hundreds of participants were terminated or otherwise separated from employment with Conrail. In 1994, approximately 330 early retirees separated from employment. In 1995, approximately 110 non-unionized employees were terminated. In 1996, approximately 840 early retirees and early resignees separated from employment. Finally, CSX and Norfolk Southern have projected, in a filing with the Surface Transportation Board, that at least 1500 additional employees who are ESOP participants will be separated from employment as the takeover is implemented.

29. A substantial number and a substantial percentage, estimated to be in excess of 40%, of the employees who previously have been covered by the plan as ESOP participants have been severed from employment by Conrail as of the date of this Complaint.

Appendix C

E. *The Takeover Battle for Conrail*

30. In August 1994, representatives of CSX Corporation began contacts with Conrail to discuss a business combination. In July 1996, the chief executive officers of Conrail and CSX began formal discussions to explore a merger or acquisition. Further discussions were held thereafter, and led to a personal meeting between the chief executive officers of the two companies on October 6, 1996. The two companies conducted due diligence, and on October 8, 1996 executed a confidentiality agreement to assist their considerations of a merger. On October 14, 1996, the management of Conrail and CSX executed a Merger Agreement. The CSX tender offer for Conrail was publicly announced on October 15, 1996 and began on October 16, 1996.

31. Upon the public disclosure of the merger agreement and CSX tender offer, Norfolk Southern Corporation initiated its own rival tender offer and mounted legal challenges to certain terms of the Conrail-CSX agreement. The battle of the rival offers by CSX and Norfolk Southern continued until March 7, 1997, when CSX and Conrail amended the merger agreement to permit CSX to discuss with Norfolk Southern a joint plan for the acquisition of Conrail and division of its assets. Under a later amendment to the merger agreement, dated April 8, 1997, CSX and Norfolk Southern were permitted to form a jointly owned entity to acquire Conrail, with CSX to ultimately acquire 42% of Conrail assets and Norfolk Southern to acquire 58% of the assets.

Appendix C

32. The tender offer pursuant to the April 8, 1997, arrangement was successful and substantially all shares of Conrail stock, including the shares of preferred stock held in the ESOP, were tendered in exchange for the final offering price of $115 per share of common stock.

33. As a result of the takeover battle for Conrail, the market value of Conrail common stock increased from a price of $71.00 per share of common stock on October 14, 1996 to a final trading price of $115.00 per share.

34. Upon completion of the tender offer on June 2, 1997, all Conrail shares that were then held in the ESOP, having not been tendered under previous offers, were obtained by the acquiring entity. The cash proceeds of the tender offer were remitted to the ESOP.

F. *The Dismantling of Conrail*

35. The final remaining step in the takeover of Conrail is the approval of the transaction, including its effects on the rail freight industry, by the federal Surface Transportation Board. It is expected that the takeover will ultimately be approved.

36. Upon completion of the tender offer in June 1997, Conrail ceased to be a publicly traded, independent company. Even before the final outcome of the takeover battle, the ongoing business of Conrail was severely impaired. As a company that was subject to inevitable takeover by some other entity, Conrail management had no interest in taking steps to develop its business or undertake

new ventures. The company entered a holding pattern for its new owners.

37. Once the takeover of Conrail is completed, it will cease to exist. Its assets will be divided between CSX and Norfolk Southern, its Philadelphia headquarters will be vacated, and most of the remaining employees who participate in the ESOP will lose their jobs.

G. *The Current Status of the Conrail ESOP*

38. As of the commencement of the tender offers for Conrail, the Conrail ESOP held 9,979,562 shares of Conrail preferred stock, which were convertible on a one-for-one basis into shares of Conrail common stock. As of December 31, 1996, 2.7 million shares of stock held in the ESOP had been irrevocably allocated to ESOP participants. Accordingly, upon completion of the tender offers, the ESOP held as unallocated assets the cash tender proceeds for approximately 7,279,000 shares of common stock, or approximately $823,691,000. After subtracting the outstanding balance of the ESOP loan used to purchase the shares from Conrail, believed to be between $215 and $290 million, the ESOP held net unallocated assets of at least $533,000,000.

39. On or about June 11, 1997, the current management of Conrail announced a plan to distribute the unallocated assets in the ESOP to certain employees, including, apparently, the defendant members of the Administrative Committee. The plan favors current Conrail employees no matter how brief their service. It allocates retroactively, only

to the accounts of ESOP participants who were employed in 1996, an additional amount representing the maximum possible allocation under tax regulations for calendar year 1996. It proposes to allocate in 1997, only to the accounts of ESOP participants who are employed in 1997, an amount equal to the maximum possible allocation under tax regulations for that calendar year. To maximize the 1997 allocation, Conrail will refund from the Savings Plan all of the employees' voluntary 1997 salary deferral contributions and all of the investment earnings thereon. For 1998, Conrail proposes to again allocate the maximum possible amount to those ESOP participants who are still employed in 1998. Conrail projects that this scheme should consume all of the unallocated assets, but notes that this may not be accomplished due to employee attrition or changes in employee compensation. As a result, a shrinking pool of employees, believed to disproportionately represent highly compensated and senior management who will also receive enhanced bonus and incentive pay, would divide among themselves the benefits of the enhanced value of the ESOP, to the detriment of plaintiffs and other ESOP participants who are no longer employed by Conrail. This disfavored treatment of plaintiffs and the Class will occur despite their frequently lengthy service, contributions to the success of the company, and contributions to the Plan.

40. In apparent anticipation of the above scheme, Conrail management announced in March 1997 that employees would no longer be permitted to make contributions to the Matched Savings Plan. As a result, the Matched Savings Plan ceased to be a savings plan for Conrail employees.

Appendix C

41. In his cover letter to ESOP participants explaining the ESOP distribution scheme, Conrail CEO David LeVan stated that, "Consistent with the Merger Agreement among Conrail, CSX and NS, we have terminated the ESOP portion of the 401(k) Matched Savings Plan." According to Mr. LeVan, the "primary contributor" to the status of the ESOP "was the hard work that [employee participants] put into this company that helped create tremendous value for shareholders."

42. The ESOP distribution scheme announced by current Conrail management on or about June 11, 1997 does not fairly and equitably allocate the assets of the ESOP as required by law in these circumstances. *First*, the scheme would provide no distribution at all to participants who were severed from employment before 1996, such as plaintiffs Semerad and Kaylor. *Second*, the scheme apparently would provide only a limited distribution to those participants who were employed during some part of 1996 but who no longer are employed by Conrail, such as plaintiffs Bennett, Gillooley, Alessandrini and Hewitt. Even these distributions will be reduced to the extent the participant contributed to the Matched Savings Plan in 1996. Thus, employees who did not contribute at all to the Plan, or who were not even participating in the Plan previously, will receive the largest distributions for 1996. *Third*, the scheme also would ignore the lengthy service, economic concessions, and other contributions of plaintiffs and other ESOP participants to the success of Conrail and to the resulting magnitude of the ESOP assets, which current management proposes to allocate solely to those who remain employed. For example, a current Conrail employee could receive a substantial

allocation despite the fact that he or she was hired only recently by the company, or only recently became an ESOP participant, or had not contributed anything to the Plan. *Finally*, the scheme would confer ever-greater relative benefits upon an ever-shrinking group of participants who happen to have the good fortune to keep their jobs at Conrail, such as senior management and executives who are able to negotiate for their own job security. The scheme also discriminates in favor of employees who are officers or managers, or who otherwise are highly compensated employees. In short, the announced scheme for distribution of ESOP assets is an arbitrary lottery, with the biggest winnings going to the small group of participants who have the good luck to be employed from now to the end of the distribution period.

COUNT ONE

Failure to Act in Accordance with the Law Governing Partial and Complete Terminations

43. Paragraphs 1 through 42 above are incorporated by reference.

44. Beginning in or about 1990, shortly after creation of the ESOP, a significant number (approximately 2000) and a significant percentage (in excess of 40%) of the employees who previously have been covered by and were participants in the Conrail ESOP have been severed from employment by Conrail and have ceased to be active participants in the ESOP. These terminations have occurred as a result, in part, of major corporate events such as

consolidations of operations and reductions of staff. In addition, Conrail has amended the Matched Savings Plan to preclude any further employee contributions to the Plan and has announced the termination of the ESOP.

45. These changes constitute a partial or complete termination of the Conrail ESOP.

46. Section 411(d)(3) of the Internal Revenue Code, 26 U.S.C. § 411(d)(3), and the regulations promulgated pursuant thereto require that upon a partial or complete termination of a plan, the affected current and former plan participants must receive an allocation of all previously unallocated assets of the plan.

47. As fiduciaries of the ESOP, each defendant has a fiduciary duty to follow the law applicable to the circumstances of the plan and to take those actions required by the law. Each defendant has failed to take the necessary actions to implement a fair and equitable distribution of ESOP assets, as required under the present circumstances of a partial or complete termination of the ESOP. Defendants' failure to implement a plan of fair and equitable distribution of unallocated plan assets to all current and former participants affected by the partial termination, and their implementation instead of the scheme announced by Conrail management on June 11, 1997, constitute a violation of their fiduciary duties of loyalty, fairness, impartiality and prudence under Section 404 of ERISA, 29 U.S.C. § 1104(a). As co-fiduciaries of the ESOP, each of the named individual defendants either has participated knowingly in this violation, or by his or her violation of individual

fiduciary duties has enabled other defendants to commit this violation. Accordingly, each defendant is also liable under Section 405(a) of ERISA, 29 U.S.C. § 1105(a).

COUNT TWO

Failure to Equitably Distribute ESOP Assets Upon Termination

48. Paragraphs 1 through 42 above are incorporated by reference.

49. All of the purposes of the Conrail ESOP now have been achieved. The purpose of encouraging employee savings has been fulfilled because the ESOP and the entire Matched Savings Plan are no longer available to receive employee contributions. The purpose of encouraging employee ownership has been fulfilled because the ESOP is no longer an owner of Conrail; it sold its ownership rights and now holds only the cash proceeds of the sale. The purpose of aligning the interests of the employees with those of the shareholders has been fulfilled because there are no longer any shareholders of Conrail; all of its shares are being held in a voting trust pending the expected regulatory approval of the takeover and dismantling of Conrail. Upon regulatory approval, all Conrail shares will be cancelled. On or about June 11, 1997, the management of Conrail declared the termination of the ESOP.

50. At present, the only purpose being served by the ESOP is as a custodian of, and distribution vehicle for, the proceeds of the sale of the ESOP's ownership interest in the company.

51. Under the law of trusts incorporated by ERISA and made applicable to the Conrail ESOP, the ESOP is a wasting trust in which an ever-smaller number of persons will be active participants. Pursuant to the fiduciary duties of loyalty, fairness, impartiality and prudence specified in ERISA Section 404(a), 29 U.S.C. § 1104(a), defendants are required to fairly and equitably allocate and distribute all of the unallocated ESOP assets to the current and former ESOP participants, in a manner which is free of the taint of self-interest. Defendants' failure to adopt and implement a fair and equitable plan of asset distribution, and their adoption of an inequitable scheme of asset distribution, constitute a violation of their fiduciary duties under Sections 404(a) and 405(a) of ERISA, 29 U.S.C. §§ 1104(a) and 1105(a).

PRAYER FOR RELIEF

WHEREFORE, plaintiffs and the Class pray that the Court:

A. Declare, adjudge and decree that the Conrail ESOP has undergone a complete and/or partial termination, or that it is a wasting trust, and that defendants, as fiduciaries of the ESOP, are required to promptly effect a fair and equitable allocation and distribution of all unallocated assets of the ESOP to plaintiffs and all other affected current and former participants without regard to their continued active employment status at Conrail.

B. Declare, adjudge and decree that the scheme of allocation and distribution announced by current Conrail management does not fairly and equitably allocate and

distribute the assets of the ESOP in a non-discriminatory manner and does not comply with the law applicable to partial and complete terminations of the ESOP and to the ESOP as a wasting trust.

C. Enter a preliminary and permanent injunction barring defendants from taking any further steps to implement the scheme of distribution announced by Conrail management.

D. Enter a permanent injunction, and grant other appropriate equitable relief, compelling defendants to make the required equitable distributions of ESOP assets, based upon their ESOP account balances, to plaintiffs and all other affected current and former participants who are members of the Class.

E. Order an accounting of all transactions by the ESOP in connection with the tender offers, including the repayment of the outstanding ESOP loan to Conrail.

F. Order defendants to make full disclosure of all of the facts and circumstances pertinent to the ESOP and the distribution of its unallocated assets, including all information regarding job security arrangements for actively employed senior managers and other participants.

G. Award to plaintiffs and the class and their counsel reasonable attorneys' fees, costs and other expenses of litigation.

H. Grant such other relief as may be just and proper.

Appendix C

Respectfully submitted,

Alan M. Sandals
Howard I. Langer
SANDALS, LANGER
& TAYLOR, LLP
One Liberty Place
47th Floor
1650 Market Street
Philadelphia, PA 19103-7397
Telephone: (215) 419-6500

APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DENYING PETITION FOR REHEARING DATED APRIL 8, 1999

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 97-1916/1917/1918

STEVEN W. BENNETT; EDMUND L. GILLOOLEY; JOSEPH L. ALESSANDRINI, JR.; FRANK W. HEWITT; RICHARD E. SEMARAD; WARREN E. KAYLOR, Individually and on behalf of all other similarly situated

v.

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A. MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN

Steven W. Bennett; Edmund L. Gillooley; Joseph L. Alessandrini, Jr.; Frank W. Hewitt; Richard E. Semarad; Warren E. Kaylor, Individually and on behalf of all members of the proposed class,

Appellants in 97-1916.

JOANNE KELLY, Individually and on behalf of all others similarly situated

v.

Appendix D

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A. MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN

Joanne Kelly,

Appellant in 97-1917.

GEORGE E. GALE, III, Individually and on behalf of all other similarly situated,

Appellant in 97-1918.

v.

CONRAIL MATCHED SAVINGS PLAN ADMINISTRATIVE COMMITTEE; DEBORAH A. MELNYK; JOHN/JANE DOES 1-10; CONSOLIDATED RAIL CORPORATION MATCHED SAVINGS PLAN

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil Action Nos. 97-cv-04535; 05017 & 05345)
District Judge: Honorable Harvey Bartle, III

Before: BECKER, *Chief Judge*, SLOVITER, STAPLETON, MANSMANN, GREENBERG, SCIRICA, NYGAARD, ALITO, ROTH, LEWIS, MCKEE and RENDELL, *Circuit Judges*

Appendix D

ORDER

The petition for rehearing *in banc* filed by appellant in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all other available circuit judges o. the circuit in regular active service, and no judge who concurred in the decision having asked for a rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court *in banc*, the petition for rehearing is denied.

By the Court,

s/ Jane Roth
Circuit Judge

Dated: APR -8 1999

APPENDIX E — RELEVANT STATUTES AND REGULATIONS

29 U.S.C. § 1103 [ERISA § 403] Establishment of trust

(a) Benefit plan assets to be held in trust; authority of trustees

Except as provided in subsection (b) of this section, all assets of an employee benefit plan shall be held in trust by one or more trustees. Such trustee or trustees shall be either named in the trust instrument or in the plan instrument described in section 1102(a) of this title or appointed by a person who is a named fiduciary, and upon acceptance of being named or appointed, the trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that —

> (1) the plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, in which case the trustees shall be subject to proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to this chapter, or
>
> (2) authority to manage, acquire, or dispose of assets of the plan is delegated to one or more investment managers pursuant to section 1102(c)(3) of this title.

(b) Exceptions

* * *

Appendix E

(c) Assets of plan not to inure to benefit of employer; allowable purposes of holding plan assets

(1) Except as provided in paragraph (2), (3), or (4) or subsection (d) of this section, or under sections 1342 and 1344 of this title (relating to termination of insured plans), or under section 420 of title 26 (as in effect on January 1, 1995), the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

* * *

(d) Termination of plan

(1) Upon termination of a pension plan to which section 1321 of this title does not apply at the time of termination and to which this part applies (other than a plan to which no employer contributions have been made) the assets of the plan shall be allocated in accordance with the provisions of section 1344 of this title, except as otherwise provided in regulations of the Secretary.

(2) The assets of a welfare plan which terminates shall be distributed in accordance with

the terms of the plan, except as otherwise provided in regulations of the Secretary.

* * *

29 U.S.C. § 1104 [ERISA § 404]
Fiduciary duties

(a) Prudent man standard of care

(1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and —

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

(2) In the case of an eligible individual account plan (as defined in section 1107(d)(3) of this title), the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities (as defined in section 1107(d)(4) and (5) of this title).

* * *

29 U.S.C. § 1344 [ERISA §4044]
Allocation of assets

(a) Order of priority of participants and beneficiaries

In the case of the termination of a single-employer plan, the plan administrator shall allocate the assets of the plan

(available to provide benefits) among the participants and beneficiaries of the plan in the following order:

(1) First, to that portion of each individual's accrued benefit which is derived from the participant's contributions to the plan which were not mandatory contributions.

(2) Second, to that portion of each individual's accrued benefit which is derived from the participant's mandatory contributions.

(3) Third, in the case of benefits payable as an annuity —

(A) in the case of the benefit of a participant or beneficiary which was in pay status as of the beginning of the 3-year period ending on the termination date of the plan, to each such benefit, based on the provisions of the plan (as in effect during the 5-year period ending on such date) under which such benefit would be the least,

(B) in the case of a participant's or beneficiary's benefit (other than a benefit described in subparagraph (A)) which would have been in pay status as of the beginning of such 3-year period if the participant had retired prior to the beginning of the 3-year

period and if his benefits had commenced (in the normal form of annuity under the plan) as of the beginning of such period, to each such benefit based on the provisions of the plan (as in effect during the 5-year period ending on such date) under which such benefit would be the least.

For purposes of subparagraph (A), the lowest benefit in pay status during a 3-year period shall be considered the benefit in pay status for such period.

(4) Fourth —

(A) to all other benefits (if any) of individuals under the plan guaranteed under this subchapter (determined without regard to section 1322b(a) of this title), and

(B) to the additional benefits (if any) which would be determined under subparagraph (A) if section 1322(b)(5) of this title did not apply.

For purposes of this paragraph, section 1321 of this title shall be applied without regard to subsection (c) thereof.

(5) Fifth, to all other nonforfeitable benefits under the plan.

(6) Sixth, to all other benefits under the plan.

(b) Adjustment of allocations; reallocations; mandatory contributions; establishment of subclasses and categories

For purposes of subsection (a) of this section —

(1) The amount allocated under any paragraph of subsection (a) of this section with respect to any benefit shall be properly adjusted for any allocation of assets with respect to that benefit under a prior paragraph of subsection (a) of this section.

(2) If the assets available for allocation under any paragraph of subsection (a) of this section (other than paragraphs (5) and (6)) are insufficient to satisfy in full the benefits of all individuals which are described in that paragraph, the assets shall be allocated pro rata among such individuals on the basis of the present value (as of the termination date) of their respective benefits described in that paragraph.

(3) This paragraph applies if the assets available for allocation under paragraph (5) of subsection (a) of this section are not sufficient to satisfy in full the benefits of individuals described in that paragraph.

(A) If this paragraph applies, except as provided in subparagraph (B), the assets shall be allocated to the benefits of individuals described in such paragraph (5) on the basis of the benefits of individuals which would have been described in such paragraph (5) under the plan as in effect at the beginning of the 5-year period ending on the date of plan termination.

(B) If the assets available for allocation under subparagraph (A) are sufficient to satisfy in full the benefits described in such subparagraph (without regard to this subparagraph), then for purposes of subparagraph (A), benefits of individuals described in such subparagraph shall be determined on the basis of the plan as amended by the most recent plan amendment effective during such 5-year period under which the assets available for allocation are sufficient to satisfy in full the benefits of individuals described in subparagraph (A) and any assets remaining to be allocated under such subparagraph shall be allocated under subparagraph (A) on the basis of the plan as amended by the next succeeding plan amendment effective during such period.

(4) If the Secretary of the Treasury determines that the allocation made pursuant to this section (without regard to this paragraph) results in discrimination prohibited by section 401(a)(4) of title 26 then, if required to prevent the disqualification of the plan (or any trust under the plan) under section 401(a) or 403(a) of title 26, the assets allocated under subsections (a)(4)(B), (a)(5), and (a)(6) of this section shall be reallocated to the extent necessary to avoid such discrimination.

(5) The term "mandatory contributions" means amounts contributed to the plan by a participant which are required as a condition of employment, as a condition of participation in such plan, or as a condition of obtaining benefits under the plan attributable to employer contributions. For this purpose, the total amount of mandatory contributions of a participant is the amount of such contributions reduced (but not below zero) by the sum of the amounts paid or distributed to him under the plan before its termination.

(6) A plan may establish subclasses and categories within the classes described in paragraphs (1) through (6) of subsection (a) of this section in accordance with regulations prescribed by the corporation.

Appendix E

(c) Increase or decrease in value of assets

Any increase or decrease in the value of the assets of a single-employer plan occurring during the period beginning on the later of (1) the date a trustee is appointed under section 1342(b) of this title or (2) the date on which the plan is terminated is to be allocated between the plan and the corporation in the manner determined by the court (in the case of a court-appointed trustee) or as agreed upon by the corporation and the plan administrator in any other case. Any increase or decrease in the value of the assets of a single-employer plan occurring after the date on which the plan is terminated shall be credited to, or suffered by, the corporation.

(d) Distribution of residual assets; restrictions on reversions pursuant to recently amended plans; assets attributable to employee contributions; calculation of remaining assets

(1) Subject to paragraph (3), any residual assets of a single-employer plan may be distributed to the employer if —

(A) all liabilities of the plan to participants and their beneficiaries have been satisfied,

(B) the distribution does not contravene any provision of law, and

(C) the plan provides for such a distribution in these circumstances.

Appendix E

(2)(A) In determining the extent to which a plan provides for the distribution of plan assets to the employer for purposes of paragraph (1)(C), any such provision, and any amendment increasing the amount which may be distributed to the employer, shall not be treated as effective before the end of the fifth calendar year following the date of the adoption of such provision or amendment.

(B) A distribution to the employer from a plan shall not be treated as failing to satisfy the requirements of this paragraph if the plan has been in effect for fewer than 5 years and the plan has provided for such a distribution since the effective date of the plan.

(C) Except as otherwise provided in regulations of the Secretary of the Treasury, in any case in which a transaction described in section 1058 of this title occurs, subparagraph (A) shall continue to apply separately with respect to the amount of any assets transferred in such transaction.

(D) For purposes of this subsection, the term "employer" includes any

member of the controlled group of which the employer is a member. For purposes of the preceding sentence, the term "controlled group" means any group treated as a single employer under subsection (b), (c), (m) or (o) of section 414 of title 26.

(3)(A) Before any distribution from a plan pursuant to paragraph (1), if any assets of the plan attributable to employee contributions remain after satisfaction of all liabilities described in subsection (a) of this section, such remaining assets shall be equitably distributed to the participants who made such contributions or their beneficiaries (including alternate payees, within the meaning of section 1056(d)(3)(K) of this title).

(B) For purposes of subparagraph (A), the portion of the remaining assets which are attributable to employee contributions shall be an amount equal to the product derived by multiplying —

(i) the market value of the total remaining assets, by

(ii) a fraction—

(I) the numerator of which is the present value of all portions of the accrued benefits with respect to participants which are derived from participants' mandatory contributions (referred to in subsection (a)(2) of this section), and

(II) the denominator of which is the present value of all benefits with respect to which assets are allocated under paragraphs (2) through (6) of subsection (a) of this section.

(C) For purposes of this paragraph, each person who is, as of the termination date —

(i) a participant under the plan, or

(ii) an individual who has received, during the 3-year period ending with

the termination date, a distribution from the plan of such individual's entire nonforfeitable benefit in the form of a single sum distribution in accordance with section 1053(e) of this title or in the form of irrevocable commitments purchased by the plan from an insurer to provide such nonforfeitable benefit, shall be treated as a participant with respect to the termination, if all or part of the nonforfeitable benefit with respect to such person is or was attributable to participants' mandatory contributions (referred to in subsection (a)(2) of this section).

(4) Nothing in this subsection shall be construed to limit the requirements of section 4980(d) of title 26 (as in effect immediately after the enactment of the Omnibus Budget Reconciliation Act of 1990) or section 1104(d) of this title with respect to any distribution of residual assets of a single-employer plan to the employer.

* * *

Appendix E

Treasury Regulation § 1.411(d)-2
Termination or partial termination; discontinuance of contributions.

(a) General rule

(1) Required nonforfeitability. A plan is not a qualified plan (and a trust forming a part of such plan is not a qualified trust) unless the plan provides that —

(i) Upon the termination or partial termination of the plan, or

(ii) In addition, in the case of a plan to which section 412 (relating to minimum funding standards) does not apply, upon the complete discontinuance of contributions under the plan,

the rights of each affected employee to benefits accrued to the date of such termination or partial termination (or, in the case of a plan to which section 412 does not apply, discontinuance), to the extent funded, or the rights of each employee to the amounts credited to his account at such time, are nonforfeitable (within the meaning of Section 1.411(a)-4).

(2) Required allocation. (i) A plan is not a qualified plan (and a trust forming a part of

such plan is not a qualified trust) unless the plan provides for the allocation of any previously unallocated funds to the employees covered by the plan upon the termination or partial termination of the plan (or, in the case of a plan to which section 412 does not apply, upon the complete discontinuance of contributions under the plan). Such provision may be incorporated in the plan at its inception or by an amendment made prior to the termination or partial termination of the plan [or] the discontinuance of contributions thereunder. In the case of a defined contribution plan under which unallocated forfeitures are held in a suspense account in order to satisfy the requirements of section 415, this subdivision shall not require such plan to provide for allocations from the suspense account to the extent that such allocations would result in annual additions to participants' accounts in excess of amounts permitted under section 415 for the year for which such allocations would be made.

(ii) Any provision for the allocation of unallocated funds which is found by the Secretary of Labor or the Pension Benefit Guaranty Corporation (whichever is appropriate) to satisfy the requirements of section 4044 or section 403(d)(1) of the Employee Retirement Income Security Act of 1974 is acceptable if it specifies

the method to be used and does not conflict with the provisions of section 401(a)(4) of the Internal Revenue Code of 1954 and the regulations thereunder. Any allocation of funds required by paragraph (1), (2), (3), or (4)(A) of section 4044(a) of such Act shall be deemed not to result in discrimination prohibited by section 401(a)(4) of the Code (see, however, paragraph (e) of this section). Notwithstanding the preceding sentence, in the case of a plan which establishes subclasses or categories pursuant to section 4044(b)(6) of such Act, the allocation of funds by the use of such subclasses or categories shall not be deemed not to result in discrimination prohibited by the Code. The allocation of unallocated funds may be in cash or in the form of other benefits provided under the plan. However, the allocation of the funds contributed by the employer among the employees need not necessarily benefit all the employees covered by the plan.

(iii) Paragraphs (a)(2) (i) and (ii) of this section do not require the allocation of amounts to the account of any employee if such amounts are not required to be used to satisfy the

liabilities with respect to employees and their beneficiaries under the plan (see section 401(a)(2)).

(b) Partial termination

(1) General rule. Whether or not a partial termination of a qualified plan occurs (and the time of such event) shall be determined by the Commissioner with regard to all the facts and circumstances in a particular case. Such facts and circumstances include: the exclusion, by reason of a plan amendment or severance by the employer, of a group of employees who have previously been covered by the plan; and plan amendments which adversely affect the rights of employees to vest in benefits under the plan.

(2) Special rule. If a defined benefit plan ceases or decreases future benefit accruals under the plan, a partial termination shall be deemed to occur if, as a result of such cessation or decrease, a potential reversion to the employer, or employers, maintaining the plan (determined as of the date such cessation or decrease is adopted) is created or increased. If no such reversion is created or increased, a partial termination shall be deemed not to occur by reason of such cessation or decrease. However, the Commissioner may determine that a partial termination of such a plan occurs pursuant to subparagraph (1) of this paragraph for reasons other than such cessation or decrease.

(3) Effect of partial termination. If a termination of a qualified plan occurs, the provisions of section 411(d)(3) apply only to the part of the plan that is terminated.

(c) Termination

(1) Application. This paragraph applies to a plan other than a plan described in section 411(e)(1) (relating to governmental, certain church plans, etc.).

(2) Plans subject to termination insurance. For purposes of this section, a plan to which title IV of the Employee Retirement Income Security Act of 1974 applies is considered terminated on a particular date if, as of that date —

(i) The plan is voluntarily terminated by the plan administrator under section 4041 of the Employee Retirement Income Security Act of 1974, or

(ii) The Pension Benefit Guaranty Corporation terminates the plan under section 4042 of the Employee Retirement Income Security Act of 1974.

For purposes of this subparagraph, the particular date of termination shall be the date of termination determined under section 4048 of such Act.

(3) Other plans. In the case of a plan not described in paragraph (c)(2) of this section, a plan is considered terminated on a particular date if, as of that date, the plan is voluntarily terminated by the employer, or employers, maintaining the plan.

* * * *